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Law Firm Antis Triantafyllides & Sons.

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INTERNATIONAL PERSPECTIVES IN DIRECTORS AND OFFICERS LIABILITY

DIRECTORS AND OFFICERS PERSONAL LIABILITY

The legal position in Cyprus:

1. Structure of Corporate Entities:

The law regarding registered companies in Cyprus derives from the Cypriot Companies Law, Chapter 113, as amended, (the "Companies Law"), which is almost identical to the UK's former Companies Act 1948. The Companies Law broadly provides for two forms of companies - those of companies limited by shares and those of companies limited by guarantee.

In the case of a company limited by shares, each shareholder is a co-owner of the company and the extent of his rights and duties is measured according to the amount of his shareholding. The liability of a shareholder towards the debts of the company is limited to the unpaid amount, if any, on any shares held by him.

Companies limited by shares are sub-divided into public and private companies. In order to qualify as a private company, a company must satisfy four criteria with respect to the contents of its Articles of Association. (Section 29 of the Companies Law):

- (a) The Articles of Association must restrict the right to transfer its shares;
- (b) The number of its members must be limited to 50;
- (c) They should prohibit an invitation to the public to subscribe for its shares or debentures; and
- (d) The issue of bearer shares should be prohibited.

Public companies are a residual category the Articles of Association of which do not satisfy all four of the above criteria.

Company limited by guarantee may be registered with or without a share capital and are used invariably for the purpose of the non-profit making organisations.

2. Who are Directors and Officers?:

According to section 2(1) of the Companies Law, "a Director includes any person occupying the position of Director by whatever name called".

In this way, despite the fact that a Director's position is not clarified exactly, it is clear that a company is only able to carry out its business through its Directors, as agents of the Company. Directors are not as such employees of the company, neither are they servants of the company. The relationship between the company and its Directors is regulated by the general principles of the Law of Principal and Agent.

However, Directors have a dual character, in that they are also, in some sense and to some extent, trustees. They are trustees of assets which have come into their hands, or which are under their control.

Apart from the Directors the secretary of the company is considered to be an officer. His duties are purely ministerial.

3. Legal Basis of Directors Liability in Cyprus:

(a) Statutory Duties:

Section 190 of the Companies Law has made it mandatory for Directors to disclose any interests that they may have.

The relevant provisions are now enshrined in sections 187, 188 and 189 of the Companies Law. Section 191 encompasses a common law duty on Directors, that of the need to avoid any conflict of interest. This duty is imposed on those Directors, who are either directly or indirectly interested in a contract or proposed contract with the company. Failure to reveal the nature of their interest at a meeting of Directors would result in the imposition of a fine.

(b) Common Law Duties:

Directors are required to act according to their fiduciary duties, in other words, their duties of good faith are owed by each Director individually. This duty entails to act in the best interests of the company, to exercise their powers for the particular purpose for which they were conferred and not for some extraneous purpose; not to fetter their discretion to exercise their powers from time to time and finally, despite compliance with the foregoing rules, they must not, without

the consent of the company, place themselves in a position in which there is a conflict between their duties and their personal interests.

Following on from Directors fiduciary duties is the important duty that a Director owes to the company, that is to manage it in accordance with provisions of Cyprus Law generally and with the Memorandum and Articles of Association. Failure to abide by this duty will subsequently lead to the Director being liable for breach of duty.

Directors are also required to display a reasonable degree of skill that may be expected from a person of his knowledge and experience. Basically the general principles of common law and equity applicable to agency and trust, are adopted in Cyprus law too.

(c) Duties of Directors towards majority and minority shareholders:

A winding-up order will be made if the persons who control the company have been guilty of oppression towards the minority shareholders, whether in their capacity as Directors or as Shareholders. Therefore a Director has a duty to conduct the affairs of the company in a manner that is not oppressive to some part of the members.

In such a case a petition may be filed in court for an order under section 202 of the Companies Law, Cap 113 and, if the court, whose power is unfettered, is of the opinion:

that the Company's affairs are being conducted in a manner aforesaid; and

that to wind-up of the Company would unfairly prejudice that part of the members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the Company should be wound up

the Court, may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

Section 202 does not apply exclusively to the scenario where oppression is committed against the minority shareholders, but also may be committed by a minority of the members who otherwise control the company.

"Oppressive" conduct, for the purpose of the section, means that the company has exercised its authority "in a manner burdensome, harsh and wrongful" and it must go beyond what is

required to make out a case for a winding-up order, by indicating some lack of fair dealing towards the Members (per Plowman J. in the Lurdie Brothers Ltd., 1965).

(d) Director's Duties in case of Voluntary Winding-up of a Company:

When a company proposes to wind-up voluntarily, the Directors of the company have a duty to make a statutory declaration, stating that a full enquiry into the affairs of the company has been made, and that, having done so, they have formed the opinion that the company will be able to fully pay its debts. However, as soon as a liquidator has been appointed all the powers of Directors cease, in the case of a members voluntary winding-up of the company.

In the case of creditors voluntary winding up, the Directors have a duty to compose and present a full statement of the position of the company's affairs, a list of the creditors of the company and the estimated amount of their claims to be laid before the meeting of the creditors. Further, the Directors must appoint one of the Directors to preside at the aforesaid meeting. As in the case of members' voluntary winding-up, on the appointment of a liquidator, all the powers of the Directors shall cease, except as for as the committee of inspection.

(e) Directors Criminal Liability:

Directors who put out false statements in a prospectus or statement in lieu of prospectus are prosecuted under section 44 of the Companies Law. This section provides that if a prospectus includes any untrue statement, any person who authorised the issue of the statement shall be liable to imprisonment not exceeding two years and a fine, unless he proves either that the statement was immaterial or that he had reasonable ground to believe and did believe that the statement was true. This section is subject to the general provisions of section 46 to the effect that a statement shall be deemed untrue if it is misleading in the form and context in which it is included. The most notable features of this section are that mere negligence, in the sense of an absence of reasonable grounds for belief, imposes criminal liability, and that the onus of proof is shifted to the accused once the prosecution have proved that a misleading statement has been made in a prospectus issued with his authority.

In addition to this general provision, the Law also contains other provisions imposing criminal liability for misstatements. For example, section 373, whereby any person who, in any document required by or for the purpose of certain

sections of the Law specified in Schedule 13, wilfully makes a false statement in any material particular, knowing it to be false, is guilty of an offence.

Section 307 further supplements the normal criminal law by imposing penalties on various types of improper conduct of any person, being a past or present officer of a company, which may come to light during the winding-up of a company, whether by or under the supervision of the Court or voluntarily, or is subsequently ordered to be wound-up by the Court or subsequently passes a resolution for voluntary winding-up. If an officer is convicted for any of the offences mentioned under this section, he shall be liable to imprisonment not exceeding five years for certain offences mentioned therein, or in the case of any other offence in the section, to imprisonment not exceeding two years. However, with regard to certain specified offences in the section, it shall be a defence if the accused proves that he did not intend to defraud or to conceal the state of affairs of the company or to defeat the law.

4. Statute of Limitations:

Since 1964, there is no statute that governs and defines the period within which legal action may be taken. In other words, there are no statutes of limitations relating to shareholders actions, contractual disputes, discrimination actions, sexual harassment actions or wrongful termination of office actions.

5. Who can sue?:

(a) Corporation - (derivative actions) brought by the Board of Directors or Shareholders on behalf of the company:

Normally, the company itself is the proper and only plaintiff in an action arising out of a dispute within the company. The Board of Directors would be, in such a case, the body which would start the action on the company's behalf. Failure to do so will pass on such power to the general meeting. The general meeting will exclusively have such power to initiate proceedings in the case where the Directors are themselves defendants to the same action.

Where the plaintiff is a shareholder of the company, he is not acting in representative capacity to the other shareholders, but as a representative of the company as "derivative action". Such an action could be brought by an individual member where it is impracticable for the company to do so. However, it

must be stated that not every wrong to the company justifies a derivative action to remedy it. As highlighted in *Foss v. Harbottle*, it appears that the conduct covered by such action is usually that involving either mis-appropriation of property or that which has an element of fraud through an improper motive. Further, it is required that the alleged wrong-doers must be in control of the company and that the company be made a defendant in the action. The reason for the latter is that so long as the company is a party to the action, a judgment can be given in its favour.

(b) Shareholders (direct actions and class actions):

A Shareholder of a company is able to sue where a company, where it has acted or proposed to have acted ultra vires, or where the personal rights of the plaintiff shareholder have been infringed. Where those who control the company are perpetrating a fraud on the minority or where a special or extraordinary resolution which is required has not been validly passed, then again, a shareholder is able to sue. In such cases, where the wrong has been carried out by the company, different considerations to those of derivative actions apply.

In such a case, the company is the real defendant, rather than merely a nominal one, for the reason that a judgement will be released against it, rather than just for it. Therefore, any person who has a personal right which is being infringed, can be considered as a plaintiff.

The mere fact that a Shareholder's rights are the same as those of another Shareholder/s, does not automatically mean that he should sue in a representative capacity on behalf of himself and all the others. However, should he wish to sue in such a capacity, it is an option available to him.

Contrary to derivative actions, a personal action to enforce the member's own rights, cannot be brought in respect of anything which took place prior to the time when the plaintiff became a member. The reason for this being that it would not amount to a breach of any contract with him. Finally a Shareholder personal action based on the contract in the Memorandum and Articles can rarely lead to a money judgement against the company.

(c) Creditors:

A creditor is able to sue a Director of a company. In such a case, there is also the possibility that he will be sued along with other defendants, including the company itself, affiliated companies or other defendant's. However, creditors are not always able to sue the Director's of a company to an unlimited extent. Where creditors give credit to companies limited by shares, they are in theory giving credit to a fund made up of the amounts paid or payable by members for their shares. In other words, they do not have recourse against the members to an unlimited extent.

Specifically in relation to winding up orders, irrespective of the amount of his debt, a creditor of a company may petition for a winding up order. However, a court will not make a winding up order on the petition of a creditor who has assigned equitably the whole of his beneficial interest in his debt. The only exception to the latter is if the assignee is also party to the petition. A further requirement to the acceptance of such a claim is that the creditor's claim against the company must be in existence at the date of the presentation of his petition. From the case-law, it seems that the court is reluctant to go into the merits of any defence, which the company puts forward to his claim, on the hearing of a petition. Neither will the court dismiss a petition merely because the company claims that there is a defence to the creditor's claim, with the only exception that it manages to prove that the defence will succeed on a point of law. However, if the defence is a substantial one and is put forward in good faith, the court will dismiss the petition.

(d) Trustees in Bankruptcy:

The Trustee in Bankruptcy of a member is not able to present a winding up petition on the member's behalf, despite the fact that he is representative of the bankrupt member in winding up proceedings. The only exception to this general rule is if he has been registered as holder of the bankrupt member's shares for a period of at least six months. Consequently, should the above precondition be met, the bankrupt member will not personally be able to present a winding up petition nor make any application to the court regarding winding up proceedings.

(e) Employees:

Directors are not as such legally responsible to the company's employees, customers or other 'stakeholders'. This is because we have not in Cyprus reached the stage, as in the UK, whereby there are proposals for the Directors to be sued for making decisions, which affect their customers, employees, or environment which damage the value of their business.

6. Enforceability of a foreign judgment on Cypriot Directors under Cyprus law:

The matter of the enforceability of a foreign judgment of Cypriot Directors under Cyprus law is governed by Foreign Judgment (Reciprocal Enforcement) Law (Cap.10). Under Article 4 of the aforementioned law, a person may apply to the District Court at any time within six years after the date of the judgment, to have the judgment registered in the District Court. Therefore, on any such application, the Court shall order the judgment to be registered. This law applies only to judgements rendered in the High Court in England.

7. Liability for punitive damages and the insurability of punitive damages under Cyprus law:

There has been no reported case of punitive damages against a director, in our experience.

8. Can the company indemnify its Directors under Cyprus law?:

It is possible for a provision in the Articles of Association of the company or in a contract with a company, to indemnify a Director against any liability which by virtue of any rule of law would otherwise attach to him. Such indemnity could arise in respect of any negligence, default, breach of duty or breach of trust of which a Director may be guilty, in relation to the company. For example, the Articles of Association of a company could provide that a Director will be indemnified out of the assets of the company against any losses or liabilities which he may incur, whilst carrying out his duties. However, such provisions in the Articles of Association of a company will only have effect in so far as they comply with section 197 of the Companies Law. Section 197 provides that any such indemnity provision shall be void, but that nothing in the section itself, shall operate to deprive any Director of a right to be indemnified:

- (a) in respect of something done or omitted to be done by him, while any such provision was in force;
- (b) where a company wishes to indemnify a Director against any liability incurred by him, in defending any proceedings in which judgment is given in his favour or in which he is acquitted.

9. Is Directors Liability Insurance Legal?:

Directors Liability Insurance is legal and such insurance policies do not have to be issued by a local admitted insurer. The issue of tax allocation of local premium for local Directors and Officers insurance policies has not been provided for under Cyprus law and is therefore, a matter to be dealt with according to the particular circumstances and requirements of the parties involved in each case.

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