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Observing the rules of the game

Market conditions have turned up the heat on private equity-backed company directors; but it is not an obvious job to juggle. By *Stef Oostvogels*, senior partner – Oostvogels Pfister Feyten

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Recent high profile legal battles are a reminder that the role of company director has come increasingly under scrutiny; the directors of private equity backed firms are no exception. Indeed, the global economic downturn is taking its toll. We are experiencing a surge in cases where directors are sued by stakeholders by intermediary of a director's and officer's policy in the hope to recover part of the losses. This raises a number of issues in respect of their fiduciary duties.

Further, the role of company director is often difficult and rendered more complex by an abundance of "masters". Directors often find themselves answering to the company itself, the board, majority and minority shareholders, management, employees, creditors, suppliers and clients. The dynamics at play are therefore intricate and directors increasingly feel the pressure. Lawsuits, for contravening the law (or the articles of association), as well as for wrongful management or any violation of fiduciary duties, are increasingly prevalent.

To an extent this can be addressed in certain jurisdictions. Luxembourg for example, provides specific rules that cover the basic needs of protection for exposed stakeholders and also offer a minimal guidance to directors. A careful observance of these rules will generally avoid criminal liability. However, the need for care does not stop here as the fiduciary duty goes well beyond these.

As with any other company director, private equity directors must ensure their actions and omissions are in compliance with the relevant laws and articles of association. They must also respect their duty of care, avoid conflicts of interest and justify sound management. In theory, directors must always concentrate on the company's best interest. They must be guided neither by the personal interest of the shareholder whom they are deemed to represent, nor his/her own personal interests. This is not an easy task for directors representing a majority shareholder with clear ideas of what can and what cannot be achieved by the company.

The basic corporate interest test is not an objective one. The multitude of stakeholders, each with its own personal and legitimate interest, justifies a certain level of discretionary power for the directors. The balance between this discretionary power and the duty of care vis-à-vis the company remains quite delicate.

Directors are not the only ones under scrutiny. The board yields a wide array of powers and has also raised questions concerning its effective functioning and the need for built-in checks and balances. In a dualistic management system, this will be achieved through a supervisory board. In a monolithic system, the statutory auditors and non-executive directors need to play their role. Non-executive directors must be independent, from both the management and the shareholders at the moment of their appointment but also thereafter. To put it bluntly, the directors must guarantee that transactions are always at arms' length and that there is no misuse of corporate assets, abuse of majority, or (personal) conflicts of interest.

The schoolbook cases of conflicts of interest, misuse of corporate assets and other abuses have certainly tarnished the reputation of the private equity sector in the media. There is no need to highlight that these stories can often be misleading. However, in reality, the court cases are indeed real and underline the importance of a particular attention to fiduciary duties.

Company directors are regularly in the spotlight. Their liability is certainly a sensitive and tangled subject to unravel. The less they are independent, the more they will be exposed to such legal actions. But whether a director is independent or not, it has become more important than ever to observe the rules of the game. ■

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