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CYFA 2023 Seminar #1:

Understanding Corporate Accountability: Liabilities of Directors and Secretaries in Cyprus Law

Wednesday, 13th February 2024
9.30 a.m. – 12.30 a.m.
Speaker: Ms. Androulla Poutziouris

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Course Outline

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Module 1 The liabilities of a Company Secretary in a Private Ltd Company

This module will delve into the specific liabilities of company secretaries under Cyprus law. It will explore the scope of their duties, the potential legal consequences of breaches, and the avenues for relief from liability. The module content will be as follows:

- Overview of the responsibilities of company secretaries in Cyprus
- Statutory obligations and duties
- Liabilities for breach of duties
- Relief from liability
- Ratification of company secretary actions by director/shareholder.
- Risk management and compliance.

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Course Outline

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Module 2 The Liabilities of Directors in a Private Ltd Company:

This module will provide an in-depth analysis of the duties and liabilities of company directors, with a focus on the legal framework in Cyprus, referencing the Companies Law, Cap. 113, and relevant case law from the UK and Cyprus. The module contents will be as follows:

- Overview of the role and duties of a company director under Cyprus law.
- Fiduciary Duties of Directors
- Exercising independent judgement
- Duty to exercise skill and care
- Statutory Duties
- Liability during winding up
- Criminal Liability risks
- Liability of executive and non-executive directors
- The myths of nominee directorship
- Insurance for Liability and Directors indemnity agreements.

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Module 1

THE LIABILITIES OF A COMPANY SECRETARY IN A PRIVATE LTD COMPANY

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What is a Company Secretary?

- A company secretary is the person or body corporate appointed by the directors to carry out the duties and function of the secretary.
- The duties of the company secretary are defined in company law.
- To this may be added further duties by the board of directors which are normally administrative.
- Therefore, the company secretary acts in accordance with the directors' instructions and their main functions are normally to oversee the **company's day to day administration** and to ensure specifically that the company complies with the law and observes its own regulations.

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Definition according to the law

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As per **Article 1 the First Schedule, TABLE A, PART I of Cap. 113** (Companies Law):

"Secretary" means any person appointed to perform the duties of company secretary.

“Γραμματέας” σημαίνει οποιοδήποτε πρόσωπο που διορίζεται να εκτελεί τα καθήκοντα του γραμματέα της εταιρείας.

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Broad definition
No determination as to secretary’s duties.

Note: There are 394 provisions in CAP 113 and many attachments – The word “secretary” is mentioned only 26 times!

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The Requirement to have a Company Secretary

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- Every company is required by law to have a company secretary, who may be one of the directors.
- Where a company has only one director, that person cannot hold the office of secretary of the company - Article 171 CAP 113
- As per 172 - A company is precluded from having as secretary a corporation, the sole director of which is a sole director of the company, or having as sole director, a corporation the sole director of which is secretary to the company.

FOR EXAMPLE:

- **COMPANY X** is not able to appoint **COMPANY Y** has its secretary where the sole director of X AND Y are the same person.
- **COMPANY X** is not able to appoint a person, when that person is the sole director of **COMPANY Y,** and **COMPANY Y** is also the sole director of **COMPANY X.**

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Corporate secretaries?

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- Contradicts with the definition of secretary given under Article 1 of the First Schedule, TABLE A, PART I
  - "person"
- Possible to appoint other entities as company secretaries - known as nominee company secretaries
- Not efficient for substance requirements reasons
- Who will attend the meeting? Who will keep proper minutes?
- In other countries, company secretaries must have a license to be a company secretary. E.g. Hong Kong as of 2018.
- Under Maltese law –the entity must be a licensed entity under the Corporate Services Provider law and can only be a natural person.

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Qualifications of a Company Secretary

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- No qualifications
- Must be over 18 year(s) old,
- Articles may specify particular qualifications.
- Regulated companies may need to hire company secretaries with specific qualifications according to the laws/regulations that regulate their activities.
- It is the duty of the company directors to ensure that they appoint a person that has the skill to carry out their legal and other duties.
- The board of director's would fail in its duty of care if they appointed someone who does not have the ability and/or access to the relevant advice to enable them to carry out the role. – how can a Director avoid this liability, when the secretary has no specific skills? Education!
- Harder when the secretary is a corporation? Who do we look at there? The directors as the alter ego of the company – applying the alter ego doctrine?

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Appointment of company secretary

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- HE 3 – must be lodged with the Registrar of companies – integral part of the registration process of a company.
- Any other matters dealing with the appointment and removal of the secretary are left up to the articles of association.
- Article 110 TABLE A – states that the secretary is to be appointed by the directors for such terms and remuneration that they think is fit.
- In addition, the secretary can be removed by the directors.

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- According to Cap 113;

- Every company maintains a registry of its directors and secretaries at its registered office.

The registry includes the following details for the secretary:

a. In the case of an individual, their name and surname and usual residential address.

b. In the case of a legal entity, its corporate name and registered office.

This creates a duty of disclosure of this information from the entity/person who is appointed secretary.

No secretary?

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- Section 171 (2)
- If the secretary is unavailable,
- If the secretary position is not filled

- Any director of the company can fill the role of the secretary and perform duties of the secretary (best practice – resolution from the other directors giving power to the director to fulfil the duties of the secretary in these situations).

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- ***Times have changed.***
- *"A company secretary is much more important person now than he was in the past…. He is no longer a mere clerk"*

- **Lord Denning MR in Panorama (1971) 2QB 711, CA**

Now?

- Different role than in the past
- Managerial function
- Chief of staff
- Advisor to the board
- Corporate governance officer (UK corporate governance).

Duties of a company secretary /

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Based on present day corporate practice, CAP 113, Table A and case law, duties can be split into 3 categories:

1. Statutory duties
2. Fiduciary duties? – e.g. Duty to exercise due care and skill and diligence
3. Administrative duties – if assigned? What comes into the remit of the secretary?

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1. Statutory duties

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- **Section 120 (I):** Sign the annual return.
- **Section 341:** Verify the statement to be submitted to the official receiver on compulsory winding up, liable for a fine 85 euros for every day of default.
- **Section 104:** To make the statutory declaration in a public company (section 104).
- Authentication of company's documents, **section 37 Cap.113**
- Certificates to be sent by private company with annual return, Article **122 Cap. 113**
- Signing of balance sheet of annual return **section 118**

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Statutory liabilities for secretaries specifically mentioned in CAP 113.

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- **Section 194:**

- If the articles provide that the liability of the directors or managers of the company can be unlimited: Directors can make a proposal as to the director who will have unlimited liability.
- The secretary must make a statement based on that proposal, if the secretary defaults in making the statement on the proposal that the director will have unlimited liability, then he shall be liable to a fine not exceeding 854 EUR, and liable for any damage which the person so elected or appointed may sustain from the default.
- Following proposal and statement, there must be a special resolution for that director to have unlimited liability.

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Duties according to Table A

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- **PROVISION 48: PROCEEDINGS OF THE DIRECTORS**
  - A director may, and the secretary on the requisition of a director shall, at any time summon a meeting of the directors
- **PROVISION 57 – THE SECRETARY**
  - **Appointment and Removal (provision 57):** The secretary of the company is appointed by the board of directors. The terms of this appointment, including the length of service (term), payment (remuneration), and other conditions, are determined by the directors. The board also has the authority to remove the secretary from their position.
  - **Separation of Roles** (**provision 58):** This provision emphasizes the separation of roles between a director and the secretary. It states that if a law or company regulation requires a certain action to be performed by both a director and the secretary, it cannot be fulfilled by a single individual acting in both capacities. This is to ensure checks and balances within the company, preventing the concentration of too much power or responsibility in a single individual's hands.
  - **Countersigning Documents (provision 59):** Every time the seal is affixed to a document, it must be countersigned. This involves a director signing the document alongside either the secretary, a second director, or another person appointed for this purpose by the directors. This countersignature acts as a witness to the sealing process, adding another layer of verification to ensure that the use of the seal is authorized and appropriate.

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All other statutory liabilities:

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- Under the provisions of CAP 113 – Where a reference to an '**officer'** of the company is made – this shall include directors and company secretaries.

- "αξιωματούχος" σε σχέση με νομικό πρόσωπο περιλαμβάνει διευθυντή, διευθύνοντα σύμβουλο ή γραμματέα·

- This means that where the law imposes liability on **officers**, the term will encapsulate company secretaries so that for instance they will be liable in circumstances where there is any default established as regards:

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Officers Liability under CAP 113

Section 9 CAP 113:

In the case of a limited liability company by guarantee, the articles of association must state the number of members with which the company is to be registered.

1. When a limited liability company by guarantee increases the number of its members beyond the registered number, it must notify the company registrar within fifteen days.
2. Failure to do so = fine in default (πρόστιμο για παράλειψη).

Section 25 CAP 113.

1. Whenever any member requests a company to send them a copy of the MEMO and articles of association, the company sends them after the member has paid fifty mils or any other lesser amount that the company may have set.
2. If a company fails to comply with this article, the company and any officer of the company who fails to comply is subject to a fine not exceeding twenty-five CY pounds for each offense.

Officers Liability under CAP 113

Section 26 Cap 113.

When a change is made to the founding document of a company, every copy of it issued after the date of the change must be in accordance with the change.

When, after such a change, the company at any time after the date of the change issues copies of that do not conform to the change, it is subject to a fine not exceeding twenty-five pounds for each copy issued in this way, and every officer of the company who is responsible for the omission is subject to the same penalty.

Officers Liability under CAP 113

Section 31 CAP 113

- When a private company modifies its articles of association in a way that no longer includes provisions required by Article 29 to be private, it ceases to be a private company from the date of change.
- Within 14 days from the date of change, the company must submit a report instead of an application for registration to the company registrar in the prescribed form.
- Failure to comply with subsections (1) or (2) results in a penalty of 250 pounds for the company and its responsible officers.
- Submitting a report with false statements can lead to imprisonment for up to 2 years and/or a fine of up to 1500 pounds, unless proven that the false statement was made under reasonable belief of its truthfulness.
- Defining False Statements in Reports:
  - A statement is considered false if it is misleading in form or content.
  - A statement is considered part of the report if it is included directly, or through any reference or memorandum appearing or incorporated in the report.

Officers Liability under CAP 113

Section 53(1):

- Companies are generally prohibited from providing direct or indirect financial assistance, in any form (e.g., loans, guarantees, security), for purchasing or subscribing to its own shares or those of its parent company
- Violating these regulations subjects the company and responsible officers to a fine not exceeding 500 pounds.

Officers Liability under CAP 113

Section 61

- Companies must notify the Company's Registry of any Capital restructuring.

- In case of non-compliance with this article, the company and its responsible officers are subject to a penalty.

Section 62

Notification of increase in share capital to Company’s registrar

In case of non-compliance with this article, the company and its responsible officers are subject to a penalty.

Section 69:

Legal consequences for company officers who intentionally conceal or misrepresent creditor information, emphasizing the severity of such actions with the possibility of imprisonment, fines, or both.

Imprisonment for up to two years.

A fine not exceeding 1500 pounds.

Or both imprisonment and fine.

Officers Liability under CAP 113

Section 70

Variation of class rights:

When variation has been submitted to consent of the court.

Court order must be filed with Companies Registrar within 15 days. – penalty in accordance with article 375.

Section 76

If a company refuses to register a transfer of shares or debentures, it must, within two months from the date the transfer was submitted to the company, send a notification of refusal to the transferee.

Failure to comply with this article subjects the company and its responsible officers to a penalty in default.

Officers Liability under CAP 113

Section 78

Company has an obligation to issue certificates

Failure to comply with this article subjects the company and its responsible officers to a penalty in default

Section 91: obligations for registration of charges 250 CY pounds

Section 99: Register of charges must be filled 250 CY pounds.

Section 100: Register must be able to be inspected: 25 CY pounds

Section 102: company must have registered office and notify of changed: penalty of omission.

Officers Liability under CAP 113

Section 103: name of the company must be written correctly in commercial matters : penalty in default

250 CY pounds if an officer uses the name incorrectly.

500 CY pounds if on website not used correctly

Section 105: Keeping of Register of Members:

Where a company makes a default in complying with this requirement – every officer who is in default of the company who is in default shall be liable to a default fine.

Section 106-109: Inspection of register.

Where a company makes a default in complying with this requirement – every officer who is in default of the company who is in default shall be liable to a default fine not exceeding 42 EUR and further default fine of 42 EUR.

Officers Liability under CAP 113

Section 119:

Annual return: Failure to comply with this article constitutes a criminal offense, subjecting the company and any responsible officer to a penalty. For the purposes of this subsection, "officer" includes any person whose instructions or directions the company's directors generally act upon.

Section 121:

obligations for annual report compilation and submission. Non-compliance with this article constitutes a criminal offense for the company and any responsible officer, leading to a fine upon conviction. "Officer" includes any person whose instructions the company's directors usually follow.

Officers Liability under CAP 113

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Section 130: Proxy rights in company meetings:

Any notice calling a company meeting with share capital must clearly state the member's right to appoint a proxy. Non-compliance by any company officer responsible results in a fine of up to 250 pounds.

Section 137:

A copy of any resolution subject to the provisions of this article must be submitted to the company registrar within 15 days of its approval. Failure to comply with subsection (1) subjects the company and responsible officers to a fine of 25 pounds.

Section 139:

Every company is required to maintain records of the minutes of general assemblies, board of directors' meetings, and, if applicable, managers' meetings in designated books.

Failure to comply with these record-keeping requirements subjects the company and responsible officers to a penalty.

Section 140:

Books containing minutes of a company's general assembly are kept at the registered office and are open for inspection by any member without charge during working hours. The company may impose reasonable restrictions, ensuring at least two hours of inspection per day. If inspection is denied or copies are not sent within the stipulated time, the company and responsible officers face a fine of up to twenty-five pounds for each offense, plus a default fine of twenty-five pounds.

Section 150:

If financial statements are fully disclosed, they must be in the form reviewed or audited by the auditor, including the complete text of the auditor's report. All observations, reservations, and opinions or conclusions expressed by the auditor must be presented. Issuing, circulating, or publishing financial statements contrary to these provisions constitutes a criminal offense. The company and responsible officers face a fine of up to five hundred pounds upon conviction.

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Officers Liability under CAP 113

Section 192: Register of directors and secretaries not being up to date and non notifying the registrar: penalty in default.

Officers Liability under CAP 113

Section 371:

- Companies are required to maintain records, indexes, and accounting books as mandated by the law.
- These records can be kept either in bound books or by using alternative methods.
- When records are not kept in bound books, measures must be in place to prevent forgery and facilitate detection.
- Non-compliance with the specified record-keeping requirements can result in fines, not exceeding two hundred and fifty pounds, and further penalties for non-compliance.

Officers Liability under CAP 113

Section 373

1. Knowingly making false statements in required documents constitutes a criminal offense.
2. Offenders, upon conviction, may face imprisonment for up to five years or a fine not exceeding fifty thousand pounds, or both imprisonment and a fine.

- Addresses the consequences of making false statements knowingly in any significant detail within reports, reports, certificates, financial statements, or other documents required by or for the purposes of the provisions of the law.
- Making such false statements is considered a criminal offense.

- **Section 375:**
- Establishes penalties for non-compliance with any provision of this law and introduces the concept of an "official responsible for omission."
- Both the company and any such official may be subject to financial penalties for each day the omission, refusal, or violation continues, as specified in the relevant provision of the law.
- The term "official responsible for omission" refers to any company official who, knowingly and deliberately, authorizes or allows the omission, refusal, or violation mentioned in the provision.

Limitation?

- Offenses punishable by fines can be pursued within twelve months from the date a legal practitioner becomes aware of them.

It stands to reason

- If the company secretary is tasked by the Directors of the Company to perform the tasks mentioned in the above articles: the company secretary will bear the liability and the penalty.
- **Question:** what would be the case when the company secretary has not been tasked with the task?
- If there is an employment agreement in place giving all the above power to the secretary – does this absolve the director from liability?

Limited liability of company secretaries

- The company secretary is protected by limited liability.
- However, limited liability may be lost is he/she fails to perform duties required under CAP 113 (remember though that many of the liabilities will only come into play if the secretary is responsible for that task – limited liability is only lost if the CAP 113 specifically places the accountability on the company secretary.
- The imposition of fines on the company secretary is a statutory form of lifting the corporate veil – making the secretary liable for omissions in making filings etc.
- **In the main, he/she will only incur liability if the negligent acts were knowing or deliberate. – and was responsible for those actions.**

Fiduciary duties: Duty to Exercise Due Care, Skill and Diligence

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- A company secretary is under a duty to exercise due care, skill and diligence in the performance of their duties.
- The secretary can be held liable for any loss arising as a result of their negligence.
- However, the secretary need not exhibit in the performance of their duties a greater degree of skill than might reasonably be expected from a person with their level of knowledge and experience.
- Same duty of care and skill as the director has.
- Not always clear where the line is drawn between the secretary and the director.

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Company secretary as an employee

- In Cyprus, a company secretary is indeed defined as an officer of the company, and they have various obligations and potential legal consequences if they fail to fulfil those obligations.
- While the law specifies certain statutory duties for the company secretary, such as signing and authenticating specific documents, other administrative/operational duties often fall under the responsibility of the directors.
- The directors of the company are ultimately responsible for managing and overseeing the company's operations. They may delegate certain administrative duties to the company secretary as part of their broader responsibilities.
- This delegation of duties typically occurs through a formal resolution or decision made by the board of directors.
- One of the directors duties though is to oversee the powers he/she/it has delegated.

Delegation of administrative role to the secretary.

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- **Delegation:** The board of directors, in a board meeting or through a written resolution, can decide to delegate specific administrative duties to the company secretary. This delegation should be documented and recorded in the company's records.
- **Clear Instructions:** The directors should provide clear instructions to the company secretary regarding the delegated tasks, including the scope of responsibilities, deadlines, and any specific requirements.
- **Oversight:** While the company secretary carries out the delegated tasks, the directors should maintain oversight to ensure that everything is done in accordance with legal and regulatory requirements.
- **Accountability:** The company secretary remains accountable for the tasks delegated to them, and they should ensure that they comply with the directors' instructions and relevant laws and regulations.

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What is delegated to the company secretary> Administrative role:

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- **Keep a Register of Members at the registered office**

  The register must be kept in a bound book or in some other way that allows for precautions against falsification and detection if falsification occurs. The register must include:

  - Members' names and postal addresses.
  - When they joined and (if applicable) left membership.
  - Class of membership (if the company has different types of membership).

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Administrative role

- Maintaining company statutory registers
- Preparing share or debenture certificates
- Arranging board meetings and keeping minutes of such meetings
- Ensuring proper records are maintained and keep the company's documentation in order
- Dealing with corporate correspondence (shareholders, on issues concerning transfers, calls and dividends)
- Attending general meetings and taking minutes of proceedings
- Ensuring returns are made to the registrar of companies.

Administrative role

- **Keep at the registered office or alternative inspection place a Register of Directors**
  - The register must be kept in a bound or unbound book, or electronically, provided it can be printed. It must contain:
  - Full names, with forenames in full
  - Any former name or names by which the person was known for business purposes
  - Service addresses
  - Nationalities
  - Dates of birth
  - Business occupations (if any)
  - Date elected or appointed as a director and ceasing to be a director

Administrative role

Register of secretaries

- For applicable companies (those with a secretary of having previously employed a secretary) this register must be kept in a bound or unbound book, or electronically, provided it can be printed. It must contain:
  - The name of each secretary
  - Any former name or names by which the person was known for business purposes;
  - A service address
  - Date appointed and date of ceasing to be a secretary

Administrative role

- **Keep at the registered office or alternative inspection place a Minute Book**
  - The Minute Book should be difficult to tamper with and should contain an authenticated copy of:
  - The minutes of all general meetings.
    - Written resolutions by the members and governing body meetings.
    - Minutes are authenticated if they are signed by the person chairing that meeting or the next meeting.
  - Resolutions are confirmed if they are signed by a director or the secretary. It is also good practice to keep minutes of any sub-committee meetings.
  - Minutes of general meetings, records of written resolutions and minutes of directors' meetings must be kept for at least 10 years. It is good practice to keep them throughout the life of the company and beyond.
  - Minutes of general meetings and records of written resolutions must be open to members free of charge. Minutes of directors' meetings need not be open to anyone other than the directors or auditors.
  - Any member is entitled to a copy of all or part of the minutes of any general meeting (within 14 days of asking for it).
  - There is no statutory obligation to provide anyone, other than directors or auditors, with a copy of the minutes of directors' meetings.
  - In addition, a register of holders of debentures, a register of sealings, records of directors' service contracts and directors' indemnities may also be kept (as appropriate).

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Administrative role

- **Give proper notice of general meetings to all members and to the auditor**
- Auditors (where appointed) are entitled to attend general meetings.
- **Keep the company seal (if applicable)**

Administrative role

- **Annual duties**

- **Arrange for the company accounts to be prepared and audited**
- **Responsibility for the availability of the company accounts and auditor's report**
- Members, debenture holders and any other person entitled to receive notice of general meetings must have access to the accounts and auditor's report free of charge.
- **Hold the annual general meeting (AGM) in accordance with the articles of association and CAP 113**
- **Send annual return to Companies House HE57**

ADMINISTRATIVE ROLE

- **Additional duties**
- **Inform Companies Registrar of any change to the registered office address**
- **Ensure correct procedures for passing resolutions to amend the company's governing document are followed**
- **Notify Companies House of any changes to the company name**
- **Extra duties of the secretary of a company limited by shares**
- **The secretary should:**
- Maintain the company's register of share allotments, register of transfers, and documents relating to redemption or purchase of own shares out of capital.
- Make filings to the Companies Registrar for any changes required by law to be made.

Operational judgements/decisions v. administrative decisions?

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- Operational decisions are those that involve the day-to-day management and strategic direction of the company.
- Directors are primarily responsible for these decisions.
- Administrative decisions, on the other hand, are related to the compliance and internal governance of the company, which often fall within the purview of the company secretary.
- They may be held liable for administrative oversights or negligence in fulfilling these duties, but are generally not involved in making high-level operational decisions

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- If a secretary is found liable for failing in their administrative duties, it does not automatically absolve a director from their own liabilities, particularly in relation to operational decisions.
- Directors must **exercise their own judgment** and cannot blindly rely on others, including secretaries, when making decisions.

- UK case law highlighting these distinctions and the resulting liabilities isn't readily available, but general principles can be applied.
- For instance, cases like Re D'Jan of London Ltd (1994) and ASIC v Healey (2011) underscore the importance of directors exercising due care in their decision-making.
- Re Barings plc (No 5) [1999] highlights the liability of directors for failure to supervise operational activities effectively.

Company Secretaries' Powers

- A company secretary has authority to make contracts within his or her own sphere of competence,
  for example, the day-to-day administration of the company.
- SO: a company secretary may, under the doctrine of 'ostensible authority', bind a company, where the action is one within the secretary's usual authority even if the secretary in fact had no authority to act.
- Outside the usual areas of authority for a company secretary, a company secretary has no authority to make contracts unless specifically authorised to do so by the directors.

Company secretary as per Barnett Hoares.

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- Was not authorized to represent the company in its dealings with third parties.
- The status today has been elevated
- Panorama case.

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Re Maidstone Buildings Ltd (1971)

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- So, this means that a company secretary's authority is confined to issues associated with the administrative element of corporate operations
- This means that where authority is vested in the company's directors the secretary can not take it upon himself to exercise such authority.

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Can not:

- This means that he is precluded from borrowing money on the company's behalf in the absence of actual authority to do so: **Re Cleadon Trust Ltd (1939)**
- He cannot institute legal proceedings on the company's behalf without authority **(Daimler Co Ltd v. Continental Tyre & Rubber Co Ltd) 1916**
- He cannot call for the convening of a general meeting himself without the prior authority of the company's board of directors – **re (State of Wyoming Syndicate 1901)**
- He may not affect the registration of transfer of shares without the prior approval of the board of directors **China mines Ltd v. Anderson**
- He cannot alter the share register without the Board's consent being first had and obtained – **(Re Indo- China Steam Navigation Co 1917)**

Panorama case

- The case of Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd [1971] revolves around the question of whether a company secretary had the authority to bind the company in a contract for hiring cars for his own personal use. The secretary, Mr. Bayne, acting on behalf of Fidelis, had hired cars from Panorama using company notepaper and suggesting the cars were for company use, while the managing director was absent. Bayne, however, used these cars for personal reasons and was later prosecuted and imprisoned for his actions.

- When Panorama sued Fidelis for the cost of hiring the cars, Fidelis argued that they were not liable as Bayne did not have actual authority to enter into the hire contracts.

- Lord Denning ruled that despite this, Fidelis was bound by the contracts because the secretary had ostensible or apparent authority to enter such agreements.

- The case highlights that the role of the company secretary had evolved since the 1887 case of Barnett Hoares & Co v South London Tramways Co, and that a secretary could be presumed to have the authority to sign contracts related to the administrative side of a company's operations.

Following this case and everything we have seen:

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- Mitigate the risk of such situations by ensuring that the authority granted to the company secretary is clearly recorded in the company's board minutes and in their job description.
- This formal documentation would provide clarity on the extent of the secretary's authority to commit the company and help avoid uncertainty or confusion regarding the actions taken by a secretary on behalf of the company.

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Summary and conclusions

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- The Company Secretary, as an officer of the company, may be held liable for the company's default only where it is proven that the default occurred due to their negligence, default, or breach of duty.

- This requires three elements to be established:

- it concerns a duty owed by the Company Secretary (a power delegated or within the ambit of their duties according to the statute)
- the Company Secretary failed to carry out their duty, and
- the damage suffered was caused directly by the Company Secretary's breach of said duty

The company secretary can bind the company in matters that fall within their ambit in the ordinary course of their role.

The power to act is delegated by the director, who will retain liability for the secretary.

When a company secretary is liable – it is likely that the director will also be liable.

When a director is liable – the secretary may not be liable.

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Risk mitigation

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1. Clarity of Role

With clearly defined responsibilities, there's less ambiguity about the secretary's duties, potentially limiting liability to those specific areas.

2. Independent Advice

By providing independent advice and services to the board, the secretary could argue detachment from the consequences of board decisions, reducing personal liability.

3. Collective Decision-Making

As the secretary’s appointment and removal are collective board decisions, this might shield the secretary from being seen as closely aligned with any particular director or decision, which can be advantageous if disputes arise concerning board decisions.

4. Professional Development Support

The secretary’s role in professional development and director induction could mitigate liability by demonstrating a commitment to informed and compliant governance.

5. Governance Guardian

As a governance guardian, the secretary’s liability may be limited to governance failures rather than operational or strategic missteps of the company.

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Module 2

THE LIABILITIES OF DIRECTORS IN A PRIVATE LTD COMPANY:

- The articles of association is to allocate the power of the company between the board of directors.
- Article 80 Table A – provides that the business of the company shall be managed by the board of directors who are at liberty to exercise all the powers of the company save for those allocated otherwise by the:
- Provisions of the law
- The company's constitution
- Any regulation made by the shareholders.

- Where directors entrusted by the articles to manage the affairs of the company, it is recognized that this power must be exercised collectively by resolutions at board level.

The Articles usually authority on the Board to delegate any of their powers in the following manner:

- **1. Article 81 TABLE A** – Whereby the board can appoint other persons whom they select through a power of attorney
- **2. Articles 107-109 TABLE A** – the board can confer powers to the managing director.
- **3. Articles 102 TABLE A** – the board delegates power to any committee which must conform to the board's requirements.

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Directors are agents of the company

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- Directors are properly regarded as agents of the company -
- As per FERGUSON V WILSON
- ‘The company itself cannot act in its own person…..it can only act through directors”
- The law of agency will therefore apply in respect of any contractual arrangement or transaction entered into by directors on the company’s behalf.
- This helps to safeguard the liability of the directors.

Protection from personal liability will be lost when:

- where they have undertaken personal liability and contracted in their own name
- Where the company’s name is incorrectly used as where, for example the word Ltd is omitted, thereby rendering the director liable to a fine of up to 427euros and making himself responsible to any third party for any loss incurred.
- Where the law imposes a penalty in default as discussed earlier – as an officer of the company.
- We will look at other ways the director can be personally liable. All of which will constitute the lifting of the corporate veil – where the director loses his limited liability.

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Directors

- Directors of companies typically benefit from a limited liability status, where they can trade and enter into arrangements on their company's behalf, while being personally insulated from the consequences and risks.
- There are however several circumstances when such protections are removed and directors can be held personally liable, notably arising from general breaches of their duties or following the insolvency of a company.

Directors' duties

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- Directors' fiduciaries duties, are owed to their company as a whole, and not to individual shareholders, creditors employees etc. However, in certain circumstances, director's fiduciary duties, may extend to shareholders (i.e. for example where the directors are involved in the sale of shares of a shareholder) or to creditors (i.e. for example, where a company is insolvent).

- **REMEDIES FOR BREACH OF DUTIES**

- In the event of a violation of the above duties, the company – (or any minority shareholder by a derivative action) – may bring an action against the directors for inter alia:

- • Injunction to block them for violating their duties;
  • Declarations and orders for setting aside the decisions taken;
  • Damages;
  • Restoration of the Company's property;
  • Cancellation of the relevant contracts; and
  • Account of profits.
  • Summary dismissal of director

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The Courts have over the years, construed company director's fiduciary duties, as being duties to:

- Act in good faith, and for proper purpose;
- Avoid conflicts of interests;
- Retain director's discretion; and
- Act with due care and skill

DUTY TO ACT IN GOOD FAITH AND FOR PROPER PURPOSE

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- Directors must act honestly, and in bona fide. The test is a subjective one - the directors must act in good faith in what they consider – not the court may consider – is, in the best interests of the company.
- directors may be still held, to have breached that duty, where they fail to direct their minds, to the question of whether, in fact a transaction was in the best interests of the Company as a whole
- Practical advice – ensure best interests' motivations are recorded in minutes and or the resolution itself.
- directors must use their powers only for the proper purpose. For the benefit of the company and not for their personal benefit. This is known as the "proper purpose principle".
- Formulated by Lord Greene MR in **Re Smith & Fawcett Ltd [1942] Ch 304**, where he stated that directors must not exercise their powers for any 'collateral purpose'.
- **Hogg v Cramphorn [1966] 3 All ER 420**
  - The directors allotted new shares;
  - They did this not because the company needed more capital (the proper purpose) but in order to avoid a takeover bid by another company.
- **Criterion Properties Plc v Stratford UK Properties LLC [2002] 2 BCLC 151**
  - An agreement was entered into with a shareholder which required the company to buy the shareholder out at a high price in the event of change of control or management.
  - The agreement was made to put off an unwelcome takeover bidder;

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- **Extrasure Travel Insurances Ltd v Scattergood [2003] 1 BCLC 598**

- It was said;

- "It is unnecessary for a claimant to prove that a director was dishonest, or that he knew he was pursuing a collateral purpose. In that sense the test is an objective one."

- A four-part test was formulated for determining whether a power was exercised for a proper purpose. **The court must:**

- Identify the power whose exercise is in question;
- Identify the proper purpose for which that power was delegated to the directors;
- Identify the substantial purpose for which the power was in fact exercised; and
- Decide whether that purpose was proper.

Loyalty and no conflict of interest

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Directors also owe strict duties not to permit any conflict of interest, or conflict with their duty to act in the best interests of their Company, as a whole.

Directors are liable to account for any secret profits, made in the discharge of their duties.
Directors should not act as directors of competing companies, as their duties to each company would then conflict, with each other.

Industrial Development Consultants v Cooley [1972] 2 All ER 162 – company did not want a contract for itself. Director terminated employment to take advantage of that contract for himself. – breach and liable to account for the profit he/she made.

Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 – directors were liable to account for a profit they made – as a result of their position as directors. Used their specialized knowledge – HofL made them liable.

CMS Dolphin Ltd v Simonet Ltd [2001] 2 BCLC 704 - solicitation of clients is akin to misappropriation – liable to account for profits

Solution? Transparency and consent.

A director is not accountable for the profits of a competing business which he may be running (Bell v Lever Bros Ltd [1932] AC 161) – unless the articles or his service contract expressly provide so;

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Duty to use independent judgement

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- Watch out – nominee directors
- Directors cannot without the consent of their company, fetter their discretion in relation to the exercise of their powers, and cannot bind themselves, to vote in a particular way, at future board meetings.
- This is so even, if there is no improper motive, or purpose and no personal advantage to the director.
- **Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606** Lord Denning: "It seems to me that no one, who has the duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties…no stipulation is lawful by which he agrees to carry out his duties in accordance with the instructions of another rather than on his own conscientious judgment".

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Duty of care and skill

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- Traditionally the level of care and skill, a director must demonstrate, has been framed largely with reference to a non-executive director. In the English case RE CITY EQUITABLE FIVE INSURANCE CO, it was expressed, in purely subjective terms, where the Court held that:
- "a director need not to exhibit in the performance of his duties a greater degree of skill, than may reasonably be expected from a person of his knowledge and experience……."

- However, a more modern approach has been adopted in the English case DORCHESTER FINANCE –V- STEBBING, where the Court held with respect to diligence, what was required was:
- "such care as an ordinary man might be expected to take on his own behalf……."
- The standard is that of a reasonable man looking after his own affairs:
- **Re City Equitable Fire Insurance Co [1925] Ch 407**

- In more modern times, a higher standard of competence may be expected of a director who is an expert in a certain field – eg accountant, finance or engineering;

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Statutory duties of a company director

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- All provisions in the law relating to the Officers of a company.

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Table A

Who is likely to have a claim against a director?

1. **The company:**

- A Directors statutory duties are owed to the company.
- Foss v Harbottle – the company is the proper claimant when the director breaches his statutory duties.
- Directors also owe fiduciary duties to the company – Foss v Harbottle applies here too.
- Director can also owe contractual duties to the company – if there is a service agreement in place.
- Where the director has held himself out to have authority to enter into a particular transaction – he is said to have ostensible (apparent authority) and can thus bind the company.
  - The third party according to **Section 33A CAP113** provides that the validity of an act done by a company shall not be called into question on the ground of lack of capacity or anything in the company's Memorandum. This means that any transaction which is ultra vires – is still valid and binding on the company.
  - The company, however, may be able to sue the director for any losses incurred (and/or dismiss him). An extension of the indoor management rule developed under UK case law. **Royal British Bank v Turquand (1856) 6 E & B 327**

2. Shareholders.

- Foss v Harbottle – However, it is for the company to pursue the claim for the director's breach - proper claimant is the company.
- However,
- Shareholders can pursue a derivative action. (claim on behalf of the company
- Individual shareholders may have an action against the director personally? for breach of fiduciary duties towards them Sharp v Blank and Peskin v Anderson (no reflective loss).

Case law – do directors owe a fiduciary duty to shareholders:

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- **Peskin v Anderson,** in which the Court of Appeal stated at para [33] that:

- 'The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that legal relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities, which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders'

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Sharp v Blank [2015] EWHC 3220 (Ch)

- the court indicated that the special circumstances necessary to form a fiduciary relationship are more likely to exist in cases of **'companies which are small and closely held, where there is often a family or other personal relationship between the parties, and where, in almost all cases, there is a particular transaction involved in which directors are dealing with the shareholders, from which the directors often stand to benefit personally.**
- The imposition of a fiduciary duty in such circumstances reflects the fact that directors who have a close family or other personal relationship with shareholders, and are entering into transactions with them, may be tempted to exploit that relationship to take unfair advantage of the shareholders for their own benefit'

Kelly and Anor v Baker and Anor [2022] EWHC 1879 (Comm)

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- The English High Court case addressed the question of whether directors can owe fiduciary duties directly to shareholders
- The case involved a family business, where Mr. Kelly, a family member, director, and shareholder of the concerned companies, claimed he was misled about the nature of the companies' sale, which was a management buy-out. He alleged the sale was undervalued due to the defendants' conflicting interests, breaching fiduciary duties to him and his controlled company.
- The Court acknowledged that fiduciary relationships between directors and shareholders can exist outside traditional contexts, especially in small, closely held companies where personal relationships might influence business operations. However, the key factor is whether there's a legitimate expectation for one party to act in the interest of the other, based on their relationship.
- Upon reviewing the facts, the Court concluded that no fiduciary relationship existed in this case. It was determined that the defendants did not have significant control or influence over the claimants' financial and business affairs to establish a fiduciary duty. Additionally, Mr. Kelly was actively involved in the sale process and did not rely solely on the defendants' advice.

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3. Creditors:

- When the company is insolvent or close to insolvency it becomes incumbent on a director to consider the company's interests as being aligned with those of its creditors as a whole
- A failure to consider the company's creditor's interests in such circumstances may amount to the company having a claim for breach of duty against the directors.

- For example, a creditor might have a contractual remedy against a director if the latter has provided any personal guarantees or in tort if it is able to establish a director's personal liability

- When a company enters insolvency or its ''vicinity'', the fiduciary duties of directors are no longer owed to the company as a whole, and instead their duties shift towards the creditors. [**Kinsela & Anor v Russell Kinsela Pty Ltd [1986] 4 NSWLR 722; West Mercia Safetywear Ltd v Dodd (1988) 4 BCC 30**

3.B Liability of a director in tort to third parties

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This may seem quite contentious as a concept. It is tantamount to making the directors and officers to personally guarantee the tortious liabilities of a company

As a general rule, a director will not be personally liable for inducing a breach of a contract committed by their company where the director has acted "bona fide within their scope of their authority" **Said v Butt 1920 3 KB 497.**

Antuzis v DJ Houghton Catching Services Ltd and others [2019] EWHC 843, the High Court found that the sole director (and 100% shareholder) and the company secretary of a company were both personally liable for inducing its breaches of contract. Modern slavery and not paying minimum wage breached the employment agreement with employees.

This case stands as a warning of the risk for officers that there may be circumstances when they will not be able to hide behind the limited liability of the company.

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- "There is, plainly, a world of difference between, on the one hand, a director consciously and deliberately causing a company to breach its contract with a supplier, by not paying the supplier on time because, unusually, the company has encountered cash flow difficulties, and, on the other hand, a director of a restaurant company who decides the company should supply customers of the chain with burgers made of horse meat instead of beef, on the basis that horse meat is cheaper. In the second example, the resulting scandal, when the director's actions come to light, would be, at the very least, likely to inflict severe reputational damage on the company, from which it might take years to recover, if it recovered at all."

Claimants (third parties) may be able to pursue directors personally if they can show that the director knew that his/her actions were in breach of his/her duties owed to the company

Directors may be liable for the torts of the company committed at their direction. Torts include actions for negligence and intentional conduct causing injury to another's economic interest.

SUMMARY: For torts involving breaches of contract (e.g. where a director intentionally induces the Company to take action and the director knows such action will cause a breach of a contract between the Company and a third party), a director may be personally liable if they did not act in good faith and within the scope of their authority. Put another way, a director may be liable if there was detriment to the company and their actions were in breach of their duties.

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4. Liquidators and administrators:

Have significant powers to being proceedings against directors – misfeasance and in respect of past transactions

Yukong Line Ltd v Rendesburg Investments Corpn (No 2) [1998] 1 WLR 294, despite this duty shift a director cannot be sued by individual creditors because he does not owe direct fiduciary duties towards them.

Therefore, actions against them are brought by the liquidator on behalf of the company, which at this point is synonymous to the creditors and not the shareholders.

- As a safeguard against possible abuses of power, directors of failed companies face certain restrictions on their activities in the immediate aftermath of an insolvency.
- Directors face the real threat that they may become personally liable for the debts of the company should the civil or criminal penalties for fraudulent and wrongful trading apply.
- • Where the company continues trading while being insolvent, the directors face the risk of incurring personal liability charges for fraudulent trading, however, such claims are rare in Cyprus.
- **S311 (1) CAP113 provides that if in the process of corporate liquidation it transpires that:**
  - "any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court, on the application of the official receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper to do so, declare that any persons who were knowingly parties to the carrying on of the business in the manner aforesaid , shall be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company as the Court may direct"

NOTE:

"any persons who were knowingly parties" encompass anyone, (such as a director, auditor, creditor, banker, adviser etc.), who has played a part in perpetrating or facilitating the fraudulent activity in issue.

Thus, in Re Maidstone Building Provisions Ltd (1971),whilst a company secretary could, in principle, be caught by the provision, his omission in alerting the directors that the company was insolvent, did not suffice, on the facts, to render him liable under S213 of the Insolvency Act 1986 (IA 1986) - corresponding statutory provision under English law.

WHO CAN BRING AN ACTION UNDER SECTION 311?

- the official receiver,
- a contributory (shareholder) or
- Creditor

Types of conduct

Obtaining of credit from suppliers with no intention of paying for those goods;

- Encouraging customers to place large deposits with no intention of suppling the goods;
- Obtaining credit from banks and factors by false invoices or accounts;
- Falsifying accounts to show inflated profits;

Wrongful trading in Cyprus?

When a director continues to run the company at a time when he knew or should have concluded that there was no prospect of the company avoiding insolvent liquidation (accruing debts when insolvency is inevitable).

Sequana judgment (BTI 2014 LLC v Sequana SA [2022] UKSC 25)

In a nutshell, in the Sequana judgment, the Supreme Court

clarified that in the vicinity of insolvency, the duties of a director extend to the company's creditors (the so called 'creditor duty').

- Applying the West Mercia case reasoning.
- Called the West Mercia Rule.

According to the Supreme Court, a director will need to consider the interests of the creditors (in a manner that is appropriate to the circumstances of the company at the time), if:

1.The company is insolvent or bordering on insolvency.

2.An insolvent liquidation or administration is probable.

3.The transaction in question would place the company in either of the foregoing two situations.

In summary, the West Mercia rule can allow creditors to recover debt owed to them despite the lack of provisions like s. 214 IA 1986, statutory limitations and difficulties surrounding the area of insolvency. Its function as a remedy can allow a creditor to recover from the directors for breach of their duties, or even provide a way to claim against other creditors for dishonest assistance.

- For now, this function of the West Mercia rule does not seem to have come for examination before the court, but the fact that authoritative cases like West Mercia v Dodd and Kinsela v Russell Kinsela have been cited with acceptance by Cyprus courts, shows promise that such an approach can be adopted.

Nominee director liability?

- The Law Commission in its Consultation Paper on Directors' Duties 1998 (CP 153), explained the term ''nominee director'' as referring to

- **persons who, independently of the method of their appointment, but in relation to their office, are expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to some person or persons other than the company as a whole.**

- In the English case of **Hawkes v Cuddy (2009) EWCA Civ 291** it was held that even though a director may owe duties to his nominator, such duties do not arise out of his nomination, but out of a separate agreement or office and they cannot detract from his duty to the company of which he is a director when he is acting as such.

- *Additionally, in the English case of* ***Central Bank of Ecuador v Conticorp SA [2015] UKPC 11****, it was held that:*
- ***"…A nominee director is not entitled to forego, or surrender to another, any exercise of his discretion, however paltry the amount he may be paid. Under the International Business Companies Act, section 55, a director must "act honestly and in good faith with a view to the best interests of the company", and must also "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances".***
- This case went on to state that it was the duty of the 'nominee' director to understand the affairs of the company and to apply his own mind to those interests.

- Additionally, in the recent decision of the Supreme Court of Cyprus in the case of Criminal **Appeal No. 323/2015 Attorney General of the Republic v Solomonidi**, the Cypriot Court adopted a similar approach with that expounded in English case law, and stated that:

- **''There are no formalistic (τυπικοί) directors of a legal person. From the moment a person is appointed as a company director he has all the responsibilities and obligations of a director, as those are determined by the Companies Act (Cap 113), any relevant applicable legislation and case law on the matter.''**

- What these decisions further show, is that a nominee director will not avoid liability by claiming that he had no real knowledge of the affairs of the company and/or any contracts entered into by the company.

- Furthermore, due to the fact that it has been established that a nominee director does not differ in terms of duties and liabilities from any other company director, it means that like any director he can be found liable to compensate an outsider for harm suffered by the company

- Nominee directors are the members of the board of directors who are appointed by an appointer – who probably has a large shareholding in the company.

- **Irish Press v. Ingersoll Irish Publications Ltd.** – court stated that the nominee director cannot ignore his common law and statutory duties – but he can follow the instructions of his nominating party – as long as those instructions do not affect other members or the company adversely. (Boulting case)

- FINAL NOTE: THE NOMINEE DIRECTOR DOES NTO OWE ANY LESS OF A DUTY TO THE COMPANY.

- **Fine balance between commercial reality and the law**. – the nominee director must strike a balance between the two.

- **'the life of a nominee director who votes against the interests of his appointing shareholder is neither happy nor long'. Ontario Ltd v Harold E Bellard Ltd.**

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Tort claims against the director:

- There are a number of torts which may be relevant in the context of a claim against a director. For example, a party might be able to pursue a claim for:
- Negligence
- Negligent misstatement
- Misrepresentation and misleading statements
- Deceit.

Personal liability in contract law?

There are a number of ways, however, in which a director can be personally liable in contract, including:

1. personal guarantees/security—a director might have agreed to personally guarantee or otherwise secure the obligations of the company (such as bank overdrafts or leases)

2.underlying shareholders' agreements—these might contractually require a director to contribute to the company's assets and/or secure the company's debts

3. **Counterparty being unaware they are dealing with the corporate**—a contract could be held to be binding on a director personally if the director has not made clear that they are acting on behalf of the company and/or do not promptly correct attempts by the third party to make the director individually liable for the company's contractual liabilities

4. Breach of warranty of authority in a contract .

Criminal liability

The potential to be personally criminally liable:

1. for fraud,
2. Bribery,
3. Competition law
4. Data protection breaches etc,
5. Environmental, health and safety
6. Employment law offences

Which, if a director were to consent to the commission of, or the offence is otherwise attributable to their actions or omissions, can lead to criminal liability

Liability of Company Directors in Cyprus for Tax-Related Offenses

- The line between legitimate tax avoidance and tax evasion is thin and thus, both companies and their Directors must be very careful when entering into any transaction or concealing any matter from the tax authorities.
- **Companies and their Directors have a legal obligation to provide the tax authorities with accurate and no misleading information.**

- **Obligation:** Accurate and honest information provision to tax authorities.
- **Consequences:** Civil penalties, interest charges, and potential criminal proceedings.

Civil and Criminal Liabilities

- **Civil Penalties:** For non-compliance or misinformation.
- **Criminal Proceedings:** In cases of tax evasion or serious breaches.
- **Emphasis:** Liability extends to Directors individually, not just the company.

VAT Act of 2002

Sections 53(1) & 54: Directors' strict liability for company offenses. VAT legislation imposes a strict liability in the Company Director.

> Sections 53(1) and s54 of the Cyprus VAT legislation state that if a legal entity is guilty of any of the offences referred to in the law, responsibility of such an offence except from the legal entity is also with (a) all the members of the board of Directors of the company and (b) the General Manager or the Director or the Chief Executive Director of the company.

- Section 55: Civil and criminal liabilities, including fines and imprisonment (2 years).
- Remarkable Aspect: Liability even without intent to act unlawfully.

Following MOU with Troika;

- For taxes withheld at the source (like Income Tax, Special Contribution for Defence, and Social Contributions), individuals can now be prosecuted for delays in tax payments without needing to prove intentional fraud. (51A – Assessment and collection of tax legislation).
- Penalties for Non-Compliance:
- Legal entities and individuals can face a fine of €5,000.
- In more serious cases, there could be imprisonment for a minimum of two years, or both imprisonment and the fine.

- **Expanded Responsibility:**
- If a legal entity (like a company) commits the offense of non-payment or delay, key figures such as the Managing Director, Board Members, and any financial management officers can also be held accountable.
- Penalties Based on Tax Amount:
  - If the total tax due is up to €1,700, the penalty can be up to 20% of the tax due.
  - For tax amounts over €1,700, the penalty can be up to 20% of the tax due or imprisonment for up to two years, or both.

- **Stringent Rules for Fraudulent or Inaccurate Reporting:**
- If anyone, especially someone in a key position in a legal entity, submits a fraudulent or deliberately inaccurate tax declaration, they can be held criminally responsible.
- Consequences of Fraudulent Actions:
- On conviction, the penalty can be a fine up to €17,860 and/or imprisonment for up to five years.
- If convicted for intentionally submitting inaccurate information, the individual must pay the due tax amount plus a fine up to four times the additional tax amount.

- In summary, these amendments make it easier to prosecute for delayed tax payments, increase the responsibility of company directors and officers, and impose stricter penalties for fraudulent tax reporting.
- The aim is to enhance tax compliance and discourage fraudulent activities in tax matters.

Director's Liability in Cyprus for Non-Payment of VAT

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- **Recent Legal Development:** The Supreme Court in appeals 323-4-5/2015 has overturned a previous decision by the District Court, establishing a significant precedent regarding the liability of company directors in Cyprus.

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Key Findings:

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- **VAT Return Submissions**: Submitting VAT returns is now considered definitive proof that directors acknowledge the company's VAT obligations to the Cyprus Tax Department.
- **Criminal Liability for VAT Offenses:** If a company commits a VAT-related criminal act, both the company and its key officers, including directors and executive management, are held liable under Article 48's strict provisions.
- **Directorship Responsibilities:** Upon assuming a directorship or management role, there's an automatic, strict personal liability for VAT compliance, irrespective of their level of day-to-day involvement.
- **Binding Decisions:** Any VAT-related decision by the Cyprus Tax Department directed at the company also binds its officers, who have the right to object within set timeframes if they disagree with the Tax Department's actions.

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- **Implications of the Supreme Court's Judgment**
- **Business Reputation Protection:**
- **VAT Compliance:** Businesses must ensure that their VAT affairs, including return submissions and invoicing, comply with current laws.
- **Adherence to Legislation:** VAT positions taken by the company should align with legislative requirements and be justifiable.
- **Defense Preparation**: For VAT matters that are subjective or contentious, a well-documented and justified defense is crucial.

Recommended Actions for Compliance and Precaution

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- **Error Correction:** Proactively disclose and correct any VAT-related errors.
- **Seek Expert Opinions:** Utilize advanced rulings, opinions, and prepare for potential appeals or objections.
- **Defense Documentation**: Maintain thorough documentation for the company's VAT positions.
- **VAT Health Checks:** Conduct regular diagnostic checks to pre-empt disputes.
- **Engagement with Tax Authorities:** Maintain ongoing communication with the Cyprus Tax Department before, during, and after audits.

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Cyprus Criminal Code

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- Article 311 of the Cyprus Criminal Code states:

- **"Any person who a) being a Director or officer of a corporation or company, receives or possesses himself as such of any of the property of the corporation or company otherwise than in payment of a just debt or demand, and with intent to defraud, omits either to make a full and true entry thereof in the books and accounts of the corporation or company, or to cause or direct such an entry to be made therein, or b) being a Director, officer or member of a corporation or company, commits any of the following acts with intent to defraud, that: i) Destroys, alters, mutilates or falsifies any book, document, valuable security or account which belongs to the corporation or company or any entry in any such book, document or account or is privy to any such act; or ii) makes or is privy to making any false entry in any such book, document or account, or, iii) omits or is privy to omitting any material particular from any such book, document or account is guilty of a felony and is liable to imprisonment of 7 years".**

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Protecting a director from liability

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- The general rule is that a director of a company limited by shares cannot be exempted from a potential liability resulting from their acts or omissions, however there are limited exceptions to this, including:

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EXEMPTION FROM LIABILITY

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- Many raise the question if there is any way for the Company Director to become exempt of liability.
- Under section 197 of Cap.113, it is not possible to grant a general exemption in advance to Directors in respect of liability to the company.
- According to the wording of the model articles: ‘‘any provision contained in the articles of association, memorandum or in any contract with a company exempting a director from, or indemnifying him against any liability, which he may otherwise have by virtue of any rule of law in respect of negligence, breach of duty or breach of trust been guilty in relation to the company, shall be void.’’

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- However, this does not mean that the Director is deprived of any possibility of exemption or right to be indemnified in respect of anything carried out by him

- The acquisition and maintenance of insurance—directors' and officers' liability insurance (D&O insurance) is widely used to protect directors from liabilities in relation to the discharge of their duties, however such policies will typically exclude any recovery in respect of fraud or dishonesty.
- Given that a director can still be liable pursuant to certain duties post their retirement as a director (for example, the duties to avoid conflicts of interest or improper use of information derived from their role of director), D&O insurance might need to provide ongoing protection

- the company giving qualifying indemnities to its directors against certain liabilities—in particular, directors may be indemnified in respect of certain costs and expenses relating to proceedings brought by third parties
- An indemnity for a director is a legal agreement designed to protect directors from personal financial loss if they are sued or held legally responsible for their actions as directors of a company.

Contents of an indemnity

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- Clearly defines the circumstances under which the director will be indemnified. This typically includes protection against legal actions brought against the director for acts or omissions made in the performance of their duties as a director. It should specify the types of costs, losses, or liabilities covered.
- Identifies situations where the indemnity does not apply. Common exclusions include actions where the director is found to have acted fraudulently, dishonestly, or in wilful breach of duty.
- Provision for the advancement of legal costs and expenses as they are incurred, subject to an undertaking by the director to repay these costs if it is later determined that they are not entitled to indemnification.
- Specifies how long the indemnity remains in effect. It often extends beyond the director's tenure to cover actions taken while they were serving as a director.
- Details any directors and officers (D&O) liability insurance policies that are in place, which can provide financial protection alongside the indemnity.
- Terms concerning the director's ability to settle a claim and the company's rights to participate in or control the defense of a claim.
- A clause that allows the company to take over the director's right to recover costs from third parties once the company has indemnified the director. (subrogation)
- Requirements for the director to promptly notify the company of any legal action and to cooperate in the defense of such action.
- Any statutory or agreed limits to the extent of indemnification, in accordance with corporate law and governance standards.
- Specifies how the indemnity can be amended and the process for approval, often requiring board or shareholder approval.
- Identifies the governing law of the indemnity agreement and outlines the mechanisms for resolving disputes under the agreement.

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Directors can also be relieved from liability by:

- the shareholders ratifying their acts, subject to such conduct being capable of ratification (Re Duomatic Ltd).
- Note in particular that it is not open to shareholders to ratify dishonest conduct and/or conduct that was not bona fide in the company's best interest.
- In Auden MckEnzie (Pharma Division) v Patel, the defendant argued in the context of an application for summary judgment that their breach of fiduciary duty involving dishonest conduct might have been consented to in the circumstances consistent with the Duomatic principle (ie the principle that if members of a company can do something via formal resolution at a general meeting, they can also do that thing informally, if all of them agree).
- However, the court was clear that such principle had 'not been developed to save conduct of this nature'

Relief under section 383 CAP 113

- Note that: In addition, the court may grant relief under Section 383 of the Companies Law, Cap. 113.
- Section 383 gives power to the court to relieve Directors, wholly or partly, from liability if in any proceedings for negligence, default, breach of duty or breach of trust if it appears to the court that the Director has acted honestly and reasonably, and that having regards to all the circumstances of the case, including those connected with the Director's appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust.
- Pursuant to section 383(2), the Director can apply to the court for relief if he apprehends that an action for breach of duty or breach of trust, negligence or default will be taken against him, and the court may grant him relief as if the case preceded it. It is notable that it is not enough for the Director to have acted honestly and reasonably, however he must additionally prove that he ought to be justly excused.
- the question whether a director acted honestly is to be answered subjectively and the test of reasonableness is to be answered objectively by reference to the knowledge, skill and experience which might reasonably be expected of a person carrying out that director's particular functions.

- Directors might also be able to protect themselves more broadly by ensuring that the following practical steps are observed:

- being aware of their duties and obligations as a director and pursuant to their company's Articles, and keeping in mind the need to exercise independent judgment

- maintaining comprehensive records, of all processes followed (including detailed board minutes evidencing such processes and the decisions taken)
- Take advice where decisions are contentious
- Seek shareholder approval
- Document the thought process and the fact that as a director you honestly believe the decision is in the best interests of the company.

Thank you.

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