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Duties of Company Directors: the Developing Law in Macedonia*

It is a fundamental rule of corporate governance that a company's directors must act, always with the highest degrees of care, diligence and loyalty to the company and its owners. This rule expresses simple fairness but it is more than that; this rule is essential if companies are to attract significant investment and it is an absolute requirement for public confidence in business and capital markets as a whole. It has been demonstrated empirically that companies that are governed honestly and fairly produce more value for their investors and, by implication, for their employees and other stakeholders.[1)]

Every company law imposes duties of these kinds in some form and to some extent, and most or all company laws provide penalties and remedies when these duties are violated. At the same time, the laws on this subject should be clear and understandable and should not be so restrictive or so punitive that they discourage qualified people from becoming direc-

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tors, or prevent honest risk taking and entrepreneurship by directors when that is in the company's interest.

This article will review the legal rules governing directors' duties in one East European country, Macedonia, and will suggest ways in which they might be clarified and reformed to further the above objectives. These rules are now set forth in the Macedonian Law on Trade Companies (hereafter, the "LTC"),[2] a large and comprehensive statute enacted in 1996 which is one of the "first generation" of Macedonian laws in the post-socialist era.

Macedonia can be considered representative of the countries of South-Eastern Europe, a region whose laws have been relatively neglected in current comparative research. Of those countries, Macedonia offers a particularly useful case study. It has adopted a relatively new company law, but one which is largely untested. There is a scarcity of case law and legal precedent, which highlights the need for clear statutory provisions. At the same time, there are associations of local lawyers and judges who are actively calling for business and company law reform. Importantly, the Macedonian Government is encouraging the process.

The activity of local groups is, in fact, reflected in many of the proposals for change put forward in this article. The proposals have already been voiced by Macedonian lawyers and judges during workshops on corporate governance and company law reform organized by CEELI since late 1999. Moreover, the suggestions have also been made directly to the Macedonian Government in the course of a process which the Government recently initiated to revise or replace the LTC.[3]

Many of the proposals discussed in the article are derived from Western, particularly United States, practice and experience. The point should be made that, while the United States' common law system differs greatly in form from the civil-law systems of Macedonia and other European countries, many solutions to company law problems are applicable universally. Indeed, while it is clear that the common law and civil law systems will retain their important formal differences, they are converging in the results they produce in practice. This is especially so in business and company law.

The discussion below will describe the present Macedonian law and presently-proposed changes in that law in four specific areas: directors' duty of care, directors' personal lia-

1. See, e.g., "Protection Money", a review of research on the relationship between corporate governance and company valuations, *The Economist* 11 December 1999,75. See also "In Praise of Rules: A Survey of Asian Business", *The Economist 1* April 2001,4, in which recent research is reported which concludes that good corporate governance can raise the value of companies by 20%-30%, and in which it is further stated that "the best western companies are now moving from the 'conformance' to the 'performance' model of governance. This means directors no longer simply comply with the rules but try to do better than that, realizing that the best practice is a competitive advantage. By contrast, most companies in East Asia are still a long way from even conforming".
2. *Macedonian Official Gazette* 1996 No. 28, amended 1997 No. 7, 1998 No. 21,1998 No. 37, 1998 No. 63, 1999 No. 39, 1999 No. 81 and 2000 No. 37.
3. In January 2000 the Macedonian Government appointed a working committee to review the present LTC and to draft suggested changes to be considered by the Government and Parliament. The committee includes representatives of the Ministries of Justice, Economy and Finance and persons from the judiciary, the practicing bar, the Skopje University, Law faculty and CEELI.

bility for their business mistakes, directors' duty of loyalty in personal conflict of interest situations and directors' duty not to engage in business competition with the company. The discussion is not an academic or theoretical analysis of the law, but rather is an attempt to describe practical issues and aspects of the current law reform process.[4)]

1. Directors' Duty of Care

A director's duty of care is difficult to define without citing examples but it is, essentially, the legal duty of a director to act with a very high degree of care, deliberation and diligence when he makes decisions for the company and when he monitors and directs the company's management. In actual corporate life, this means that a director should attend all board meetings that he possibly can (and resign from the board if he is unable to attend a significant number), give full attention to all matters that come before the board including those that may be outside his own personal expertise, make a special effort to monitor the quality of the managers' performance and ask them hard and uncomfortable questions when necessary and generally treat the shareholders' investment in the company as he would treat his own investments.

The Macedonian LTC imposes the duty of care in a particularly severe form and with much specific detail. The LTC's statement of the duty of care for joint stock company directors (set forth in Article 320) states, very simply and straightforwardly, that

> members of the board of directors must work with due care and maintain business secrets

> but the article immediately continues by saying that directors

> who violate their obligations toward the company shall *be jointly* liable for damages caused

> and, further,

> *shall have the burden of proving* that they acted with due care (italics added).

4. A preliminary point should be made regarding terminology. This article uses the word "director" to mean a person in a company who owes the company the duties which are referred to in the first paragraph above and are discussed in more detail in the article. In normal usage a "director" is (only) a member of a company's board of directors. Often, however, these duties are also owed to the company by persons who are not directors (for example, by controlling shareholders or senior employed managers), and in some circumstances the duties themselves may be different depending on, for example, whether they are born by independent directors or by employees with a management function. A well-drafted company law should define and apply those distinctions clearly, but - except to make this point here - this article will not deal with them further.
As another preliminary point, the reader should be aware that the LTC provides for two principal types of business companies, joint stock companies and limited liability companies. The provisions discussed in this article relate sometimes to one type and sometimes to the other, but the principles of good director conduct are essentially the same for both.

Article 320 further stipulates that a director owes the duty of care not only to the company's shareholders but, in some cases, directly to the company's creditors. On this point the article states that

> if a member of the board of directors *severely* violates his obligation to act with due care the company's creditors may request compensation for damages after failing to settle their claims with the company" (italics added).

The law does not contain, however, a definition of the term "severely".

Article 320 provides an exception to these liability rules, but the exception would apply only in limited circumstances.[5] It is that

> members of the board of directors shall not be liable for the damages if they acted pursuant to a decision of the company assembly that was made despite the fact that the members stated their opinion (presumably at the assembly meeting, although this is not stated) that such a decision was contrary to this law.

An analysis of Article 320 requires several critical comments. Firstly, it does not define "due care" or offer guidelines on how to recognize it.

Secondly, it provides that the directors will always be liable jointly. That is, however, in contradiction with actual corporate life where the directors' actions, and their individual culpability, could vary greatly from director to director. Further, it could be unfair to hold one director liable for the fault of another, particularly because the LTC does not appear to provide a right of contribution among jointly liable persons.

Thirdly, the provision places the burden and presumption of violation on the directors. This, in effect, makes them guilty until proven innocent.

Fourthly, Article 320 gives an outside creditor the right to sue the directors personally even though, under most company laws, the duty of care is owed only to the company and its shareholders.

Finally, as noted above, the exception to the rule envisaged in the article is very limited. It can be seen from the duty-of-care situations which typically arise in corporate life (some illustrated in the first paragraph of this section and some below). They often do not involve conduct which is brought before a shareholder assembly.

These comments lead to the conclusion that this law is simply too strict for the realities of business and corporate life. The collection of rules in Article 320 - combining an undefined standard of conduct with quite stringent and highly specific possibilities of liability - could discourage a good potential director from being willing to serve as a director at all. That could certainly be the case *if this* law were taken and enforced as written. The point might be made that in an actual lawsuit a court would moderate the article's provisions, for example, by negating or ignoring the presumption of guilt or the rule of joint liability. But on the other hand, Macedonian lawyers and judges have expressed the view that judges would be hesitant to

5. Article 320 has other significant and very detailed provisions which, however, can be considered beyond the limited point made in this article.

"make new law" in this way, especially in the Macedonian civil law system. In any event, this point does not provide an argument in favor of the law as it is now drafted.

The question of how to amend Article 320 has arisen in the course of the efforts now underway to revise the LTC. One possibility is to eliminate Article 320 altogether and not replace it, thus leaving the entire subject to be dealt within court litigation. That could be called an "American" solution. In the United States, many states' corporation statutes do not define or even refer to the duty of care; it is simply left to case law. However, this is not seen as appropriate in a civil-law system, especially in a transition country where clear definition of legal standards of conduct is much needed and where personal liability for breaches of the duty of care may now be an unfamiliar idea.

Furthermore, three points do seem clear as a result of the above analysis: (1) the present law can be made simpler, (2) the standard of care can be defined more clearly (to the extent that that is possible), and (3) the burden of proof should be put clearly on the complaining shareholder, as is the case with most other laws. With these points in mind, it has been proposed that the Article might be deleted but replaced with a short provision stating simply that a director:

> has a duty to the company to perform his functions as a director in good faith, in the reasonable belief that he is acting in the company's best interests, and with the care and attention a prudent person in a similar position would take under the circumstances

and possibly stating no more. If thought necessary, additional provisions could be added: (1) to clarify the burden of proof, (2) to state explicitly that the duty of care is not owed to third parties such as creditors, contract or tort claimants or the Government (recognizing, of course, that directors may have other duties to third parties, and that a company's claim against a director is a company asset which could become the creditors' property in a bankruptcy), or (3) to make it clear that when a director exercises his duties he is entitled to rely on financial statements and other materials which are prepared by the company's management or independent accounts or lawyers. It should be noted that the proposed language quoted above is substantially similar to that of duty-of-care laws which have been enacted in some U.S. states.

Even the above-suggested language defining the duty of care is partially subjective and, therefore, still not entirely clear. However, some subjectivity is unavoidable in this area, since each case will involve unique facts on which a court must make value judgments whenever an actual lawsuit arises. What the above proposal hopefully does do, is provide a guide to the factors and criteria which should be taken into account in making those judgments. It does this by making specific references to good faith, to the requirement of a "reasonable" belief, and the reference to a "prudent person in a similar position", however subjective those concepts may ultimately be.

The difficulty of defining the duty of care in actual practice is illustrated by a very controversial American case, *Smith v. Van Gorkom.*[*6)] The decision in that case struck fear in the hearts of many American company directors at the time but it has had the effect of raising

6. 488 Atlantic 2d 858, Delaware 1985.

the standard of care which directors, in the United States at least, are legally required to follow. A case with similar facts would be unlikely today in Eastern Europe, but it may be worth describing here because it illustrates the kinds of judgments a court must make in defining the duty of care in a lawsuit. Thus it helps make the point that the statutory law on this subject should be as clear as possible.

The case involved a publicly-traded financial services company called Trans Union whose chief executive officer had been approached by an outside party with a proposal to buy all of Trans Union's stock through an offer that the outside party would make to all of Trans Union's shareholders with the Trans Union board's approval and recommendation. The proposal was very favorable to Trans Union's shareholders; among other things, the proposed offer price was 50% higher than the price at which Trans Union's stock was then trading on the New York Stock Exchange. Moreover, Trans Union's independent outside law firm advised Trans Union's directors that they could be sued personally by unhappy shareholders if the directors did not approve the offer and did not submit it to the shareholders with the board's recommendation. In these circumstances, the directors very quickly (in a board meeting lasting only two hours) approved and recommended the offer, which was then submitted to the shareholders who overwhelmingly approved and accepted it at a specially-called shareholder meeting. Following the shareholders' approval, the merger was completed and the shareholders received their money.

Then, however, despite the high price which had been obtained, a group of the former Trans Union shareholders sued the former Trans Union directors personally, claiming that they had violated their duty of care. The claim was that if the directors had taken more time and care, and been more diligent in advocating the shareholders' interests, they could - and they would - have obtained an *even higher* price for the company.

In defending the lawsuit, the ten former directors demonstrated that they were very experienced in financial matters and that the five of them who were independent (non-employee) directors had a total of 78 years experience as chief executive officers of other major companies and 53 years as Trans Union directors, and that one of them was a prominent professor at one of the United States' most prominent university business schools. They argued that they clearly knew better than the court what their own company was worth and how much it could be sold for. (Also, there was no claim that any of the directors had a personal conflict of interest.)

To great surprise in the legal community, the court of five judges, by a three-to-two vote, agreed with the suing former shareholders and held that the directors had been grossly negligent and had violated their duty of care when they approved the sale so quickly. The court held that the directors had failed in their duty in several ways, including by not hiring an outside investment banker to provide an independent opinion on the price, and failing to take enough time and care in analyzing and actively negotiating the extensive agreements which the lawyers had prepared. The court pointed out, among other things, that the acquisition agreements which the board approved did not have a provision (which is now common in company acquisition agreements) that would have permitted Trans Union to

accept a higher offer from another outside party even after the contract with the proposed buyer was signed.

The decision was appealed but the case was privately settled before it was finally decided on appeal. Under the terms of the settlement the former directors were required to pay the former shareholders more than $20 million, of which $10 million (but only that) was paid by the board's insurance company.

Court litigation like this may lie far in the future for Eastern Europe, but it can teach the lesson - applicable everywhere - that the standards of director conduct are evolving and generally becoming higher, and that severe personal consequences can be visited on directors who violate those standards.

2. Personal Liability of Directors for Their Business Mistakes

An issue that is different from (but related to) the duty of care is that of when, and to what extent, the law should hold directors personally liable in damages for their business mistakes, *i.e.,* for business decisions which directors have made with due care but which, later and with hindsight, turned out to be bad decisions, sometimes even to the point of bankrupting the company and destroying the shareholders' investments. Under American law, a doctrine called the "business judgment rule" has evolved under which directors will normally *not* be held liable in that situation. The author has been involved in many cases where the business judgment rule was applied; typical of these are situations where a company has overpaid (in hindsight) for the acquisition of another company and has later had to sell it at a loss, and situations where a company has invested heavily in a promising new product line which then failed on the market. Such cases are often in the newspapers - a spectacular recent one involved BMW's acquisition of Rover Cars which BMW later disposed of with losses and write-offs exceeding eight billion DM.

The Macedonian LTC, on its face, rejects the business judgment rule and does so in a particularly strong way. This is done in Articles 181 and 194, which state that directors of a limited liability company:

> shall be personally *and jointly* liable to the company *and to third parties* for activities conducted contrary to law and regulations, breach of contract *and mistakes made in the management of the company* (italics added).[7]

Unlike Article 320, Article 181 also provides a remedy against offending directors which is distinctively American rather than traditionally European, namely, the remedy of a derivative lawsuit. This is a lawsuit that is brought, not directly by and on behalf of the

7. The language quoted above is in Article 181, which as drafted applies only to managers of a company. Article 194 states, however, that Article 181 (as well as Article 178, discussed later in this paper) shall apply also to members of the board of directors. It should be pointed out that Article 181, by its terms, applies to managers and directors of limited liability companies but not to managers or directors of joint stock companies. The LTC provisions for directors of joint stock companies do not appear to deal with this subject at all, which leaves open the question of whether the principles of Article 181 would be applied to them by analogy.

complaining shareholders, but rather on behalf of the company itself or in the name of all of the shareholders. Paragraph (3) of Article 181 states:

> (3) Shareholders may both file complaints for compensation of damage suffered personally and individually or jointly file a complaint for compensation on behalf of the company. Plaintiffs may request full compensation for damage suffered by the company.

This last sentence in paragraph (3) even suggests that the damages paid by the culpable director in a derivative suit may be received directly by the complaining shareholders, not (as is required in American derivative litigation) to the company only.

Article 181 is also extremely inflexible in that it provides that, in any agreement among the shareholders,

> any provision that contains a waiver of the right to file a complaint shall be void

and that

> no decision reached at a shareholders' assembly may affect the filing of a complaint to impose liability on directors for mistakes in performance of their duties.

These provisions would appear to deprive shareholders of the freedom to reduce the strictness of Article 181 by agreeing among themselves on other liability standards to which they will hold their directors - for example, by granting their directors the protection of the business judgment rule. In the author's experience such agreements - which are often carefully negotiated by knowledgeable shareholder-investors and their lawyers - are very common, particularly in limited liability companies and closely-held corporations which are organized for specific business ventures.[8)]

Summing up, several observations can be made with regard to Article 181: Firstly, as already stated, it on its face imposes strict liability regardless of whether a director's decision was made with due care and in good faith, and it would seem to limit or prevent shareholders from agreeing among themselves on their own desired liability standard, as is done elsewhere.

Secondly, like Article 320, Article 181 imposes joint liability on directors even though their culpability might be different and even though there will inevitably be some cases in which it will be unfair to hold one director liable for the fault of another.[9)]

8. This is the case in the United States and, in the author's experience, increasingly the case in Europe and Latin America. Such agreements among shareholders often contain some form of the business judgment rule, and also often contain provisions that limit the liability of the directors from liability for acts that would otherwise be violations of the duty of care or the duty of loyalty (for example, to allow a director to continue pursuing other existing businesses that might be in competition with the company in question). In some cases, such agreements are believed by the shareholders to be necessary to induce a particular director to serve; typically, the shareholders in such agreements are sophisticated investors who are aware of the risks they are undertaking.

Thirdly, another problem is that Article 181 creates direct liability of a director to third parties for the director's business mistakes, even though, as argued above, the duty of care should properly be owed only to the company and the shareholders.

Finally but most importantly, it should be said that the policy of Article 181 does something that the law should *not* do: by imposing liability for all business mistakes it can discourage or prevent directors from taking entrepreneurial risks which are for the shareholders' benefit - also the country's economy's benefit - but which could ultimately turn out badly. It puts courts and judges, who rarely have business expertise, in a position to second-guess the business judgments of experienced boards of directors.

How, then, might Article 181 be amended? This question too has arisen in the present efforts to revise the Macedonian company law. In answer, it has been suggested that Article 181 should be deleted and replaced with a simple statement of the principles which underlie the business judgment rule, such as the following:

> A director who makes a business judgment in good faith fulfills the duty of care, and will not be personally liable for damages or other legal sanctions arising from his making the judgment, if:
> (a) he does not have a personal interest in the subject of the judgment,
> (b) he is informed regarding the subject of the judgment to the full extent that he reasonably believes is appropriate under the circumstances, and
> (c) he rationally believes when the judgment is made that it is in the best interests of the company.

Like the suggested revision in section 1 of this article, this also resembles solutions followed in some U.S. states. For purposes of clarity, it would also be advisable to define the term "personal interest" in clause (a) as clearly as possible, and it has been suggested in Macedonia that the definition of "personal interest" which is described below in section 3 of this contribution be used for that purpose. The above-quoted provision might also be supplemented by rules stating clearly and objectively when an individual director will, and will not, be deemed to have agreed to actions which were taken by the board of which he is a member. On this, it has been suggested that the Macedonian law be expanded to state: (1) that a director who attends a board meeting at which any action is taken will be deemed to have agreed to that action unless his dissent is recorded in the company's record of the meeting or he files a statement of his dissent in writing with a specified company official immediately after the meeting; and (2) that a director who was absent from the meeting will be deemed to have agreed to the actions taken at the meeting unless he files such a dissenting statement immediately after he has notice of the action.

9. On this point it should be noted that while Article 181 states, like Article 320, that the directors' liability is joint, Article 181 also states, unlike Article 320, that "the court shall determine the fault of each ŠdirectorĆ if several ŠdirectorsĆ participated in acts that cause damage". This would seem to be an effort to modify the strictness on imposing joint liability, but the point should be made that imposition of joint liability at all is inappropriate.

3. Directors' Duty of Loyalty in Conflict of Interest Situations

Another fundamental duty of a director is his duty of loyalty to the company. The law should make it clear that, simply by becoming a director, a person commits his personal allegiance to the company and agrees that the interests of the company and its shareholders will prevail over any individual interest of his own when there is a conflict between them. It also means that a director must not use his corporate position to make a personal profit or to gain other personal advantage.

The duty of loyalty can arise in very different (although sometimes overlapping) types of situations. Among them are situations in which the director: (1) has a personal interest in a business transaction with the company, (2) may vote to determine his own salary or his own directors' fees or to determine the salary or directors' fees of other directors who will then be determining *his* salary or fees, (3) has the ability to use his company position or to use "inside" company information to further his personal interests in some way, (4) has the ability to take for himself, personally, a business opportunity that has come to the company and which he knows of only because he is a director of the company, (5) serves as a director of two companies and there are transactions between these two companies involved, and (6) is engaged in business competition with the company of which he is a director (discussed in section 4 of this article).

This section will discuss the Macedonian law relating to the first of these

- acts or transactions in which the director has a personal conflict of interest

- and, as above, this article will discuss possible clarifications and revisions to the present LTC provisions. The principal relevant provisions of the LTC are Articles 313 and 344. They are similar to each other except that Article 313 deals with directors of joint stock companies which have a single or "one-tier" board of directors (which under the LTC must, then, have two separate types of directors, called "executive directors" and "non-executive" directors), while Article 344 does the same for companies which have a German-style "two-tier" board system (with a supervisory board and a managing board). Under the LTC, all joint stock companies have the option of choosing which of these two systems they will adopt.

Articles 313 and 344 take the approach of declaring that certain contracts in which a director has an interest may be executed *if* they have been approved by an appropriate board majority; specifically, Article 313 states:

Contracts in which a joint-stock company is a party and in which an executive or a non-executive member [of the board] has an indirect or direct interest may be executed if the contract is approved by at least a majority of non-executive members of the board of directors.

The article then stipulates that a director shall inform the board if he knows that a contract meets the above requirements; and that the interested director "is entitled to be heard", but may not participate in the discussion or decision of the non-executive directors regarding the contract or its approval. The article also lays down a blanket requirement that the shareholder assembly be informed of all approvals.[10)]

Several observations might be made on Articles 313 and 344. Firstly, unlike the case with Article 320, which states that a director has an affirmative duty of *care* which he is personally liable for violating, Articles 313 and 344 do not state that a director has an affirmative duty of *loyalty* which he is liable in damages for violating.[11)]

Secondly, Articles 313 and 344 require that *all* interested-director contracts must be formally approved by the board. This means literally that formal approval is needed even if: (1) the contract is fair to the company, (2) similar contracts were previously approved, and (3) the contract is *de minimis* in value or importance: to take an extreme but practical example, it would cover a director's arrangement to use a company-owned car for one day or one week, both in the case where he paid the company for its use and the case where he did not.

Thirdly, Article 313 also requires that the board's approval be given in advance, foregoing the possibility (not unusual in corporate life) of board approval and ratification at a point in time after the contract has been executed. The articles, however, do not state the consequences if an interested-director contract is *not* approved by the board. Is the contract then void? Is it voidable by the company at the company's option? Is it valid but giving rise to a damage claim by the company against the director?[12)]

Fourthly, they do not define the concept of a director's "indirect or direct interest". Nor do they provide guidelines to determine when it exists: does it, for example, encompass the interest of a family member of the director?

Fifthly, they do not require that the board members who approve the contract must themselves have no interest in the contract or any related transaction; and they do not require that full disclosure of the director's interest must be made to the board, or that the approval will be effective only if the board has all the material fact about the director conflict.

Finally, they require that all such approvals be reported to the shareholder assembly even if the contract is *de minimis* in value or importance.

To deal with these points, a replacement of Articles 313 and 344 has been proposed in Macedonia that has three parts. First, it would impose an affirmative duty of loyalty on directors in *all* matters (not only contracts) affecting the company in which they have a personal interest. It would do this by stating, simply, that:

> a director who has a personal interest in a matter affecting the company has a duty to act fairly and loyally to the company with respect to that matter.

10. Articles 313 and 344 have other important, and sometimes not fully clear, provisions, and there are significant differences between the two articles, This, however, is beyond the limited points made in this contribution.
11. The closest thing to an affirmative imposition of the director's duty of loyalty in the LTC appears to be the statement in Article 314 that directors of one-tier companies "are obliged to work in the interest of the joint stock company and its shareholders *and employees"* (italics added). There does not appear to be a corresponding provision for directors of two-tier companies.
12. On these issues it should, however, be pointed out that Articles 345 and 346, which apply only to two-tier board companies, state that contracts which have been disapproved by the supervisory board may be annulled "if the contracts are harmful to the company" and that "a complaint for annulment shall be filed Špresumably with a courtĆ within three months after the contract was executed". There is not a corresponding provision for one-tier board companies.

Second, the proposed version sets forth a detailed and fairly broad definition of the term "personal interest" in the hope of forestalling the endless arguments which could otherwise ensue on when and whether it is present. The suggested definition states, among other things, that a director has a personal interest in an "act or transaction" if: (1) either he or a family member (a term which is, in turn, specifically defined elsewhere to include immediate family members and their spouses and any other persons sharing the same home with the director) is a party to the act or transaction, or (2) he has a financial or family relationship to a party to it which could reasonably be expected to affect the director's judgment adversely to the company, or (3) he is under the control or controlling influence of a party to the act or transaction which could reasonably be expected to affect his judgment adversely to the company. As in the case of the above-proposed definition of due care, this definition of "personal interest" requires some subjective judgment, but that appears to be unavoidable in dealing with this value-laden issue, where each case will be different and will often require that individual judgments be made.

The third part of the proposed amendment has the same purpose as Articles 313 and 344, namely, to state specific circumstances in which a director will be protected from liability notwithstanding his conflict of interest. The proposal does this, however, in a way that tries to answer some of the questions raised above. It states, among other things, that a director has not violated the duty of loyalty, and will not be personally liable for damages or other legal sanctions arising from his conflict, *if either* (1) all material facts concerning the interest are known to the board of directors and the board authorizes the transaction in good faith by majority vote of *disinterested* directors, *or* (2) all such material facts are known to the shareholders and the transaction is approved by *the shareholders* in good faith by majority vote at a shareholder assembly, *or* (3) the transaction, judged under the circumstances at the time it was entered into, is shown to be fair to the company.

It will be noted that clause (2) in the preceding sentence provides for the option of shareholder approval, and that clause (3) assures that the company may have the benefit of a contract which is favorable to the company even if the contract was not approved - which might have happened through inadvertence or may even have happened through deliberate concealment on the part of the interested director. It also allows the interested director the benefit of such a contract if he can show that it was favorable to the company.

4. Directors' Duty Not to Compete with the Company

While a director's duty not to compete with the company is part of his duty of loyalty, many company laws including Macedonia's deal with it separately. As will be seen below, the LTC provisions on this subject are particularly restrictive and are also different for directors of joint stock companies which have a single-tier board (covered in Article 312), for directors of joint stock companies which have a two-tier board (covered in Article 327), and for directors of limited liability companies (covered in Articles 178 and 194).

Article 312 (for directors of joint-stock companies with a one-tier board) begins with an extremely broad proscription. It states:

> Executive members of the board of directors may not perform any paid or unpaid registered activity or involve themselves in any kind of paid or unpaid activities of another company whether on their own behalf or on behalf of a third party, without prior permission of the non-executive members.

The article next states that the company' s shareholder assembly "shall be notified of decisions of the board approving the involvement of an executive member in certain activities". While this quoted language is not completely clear, it was probably intended to mean that the assembly must be notified of all decisions made by the non-executive members of the board which approve any activities of the kind described in the first part of Article 312. In a third provision Article 312 requires that, prior to the appointment of a natural person as a non-executive director, the proposer of that person shall disclose to the company's "body in charge" all of the activities of the proposed person of the type described in the first part of Article 312 (quoted above).

Article 327 (which is for directors of joint-stock companies with a two-tier board) contains the first two above-described provisions from Article 312, with the language adapted for the terminology of a two-tier board. However, Article 327 does *not* contain the third above-described provision from Article 312 (requiring disclosure), but it *does* contain important and detailed additional provisions (not included in Article 312). The latter states that the company: (1) may request compensation for damages from a managing board director who violates the board-approval requirement stated in the first part of the article; (2) in lieu of that compensation, may request of the violating director that the offending competitive actions be registered on behalf of the company, and (3) may request that the violator transfer to the company the remuneration he received for the offending competitive activity. Article 327, unlike Article 313, also has a time-barring "statute of limitations"; it states that the company's claims shall be barred three *months* after the time when supervisory board members learned of the offending actions or five *years* after those action occurred.

Articles 178 and 194 (for directors of limited liability companies) are in some ways less, but in some ways more, strict and inflexible than the provisions for directors of joint stock companies. Articles 178 and 194 state, in paragraph 1, that a director may not, without approval of the *shareholders assembly,* be a shareholder with unlimited liability or a chief officer in another company involved in similar commercial activities. Article 178 then provides, like Article 327 but unlike Article 312, that the company may claim damages or claim that the director assign the benefit of the offending activity to the company. Article 178 also provides for time-barring but differently from Article 327; the time-bar in Article 178 is three months after the directors learned of the offending activity or three (not five) years after it occurred. Article 178 combined with Article 194 also prescribes a draconian and highly specific penalty: directors *"who are not shareholders* may be expelled from their duties *without prior notice* for violating paragraph 1 of this article" (italics added).

Many observations can be made on these provisions. Firstly, the most obvious is that they are different for each form of company, whereas a director's duty not to compete with his own company should be the same whatever the form of company.

Secondly, an equally important point is that the provisions for joint stock company directors (Articles 312 and 327) *do not apply at all* to nonexecutive directors in single-tier-board companies or to supervisory board members in two-tier-board companies; those provisions apply only to executive directors and management board members. Yet a company's nonexecutive and supervisory board directors are the most senior, and legally the most important, of a joint stock company's directors. There is no reason to exempt them from the law's prohibition against competition with their companies.

Thirdly, it should also be noted that the restrictions in these articles apply to a director's involvement in *all* outside companies and activities. The restrictions apply even when the other companies or activities are *de minimis* in size and when they are not in the same business as the company of which he is a director. The restrictions also apply to a director's involvement in other companies which, even though they might be in the same business, are not in competition with the company of which he is a director. To take several examples, the articles would seem to apply to: (1) a director's involvement in charitable or civic activities which are unrelated to his company; (2) a director's investing some of his personal savings in stock of a publicly-traded company which might be in the same business as his company but where his stock represents under one per cent of the other company's public ownership and no possibility or intention of control; (3) a director of one company serving also as a director of a subsidiary of that same company; and (4) a director of a shoe-store company in one city who helps his children by investing in a non-competing shoe store which they operate in another city hundreds of kilometers away.

Finally, these articles do not in fact prohibit competition by a director with his company or state that his doing so would violate a director's duty of loyalty. They take the quite different approach of requiring, rather, that his activities outside the company - competitive or not - must be approved by the company's board. This suggests two dangers that the law should protect against: the law should not under any circumstances allow a company's board to legitimize activities of a director which constitute competition that is harmful to the company, and the law should prevent board members who themselves have an interest from voting to approve a fellow board member's competing activities.

All of these issues have arisen in the current activities to revise the LTC. In response it has been proposed to replace Articles 312 and 327 with a single provision that would: (1) apply to all directors, (2) apply only to directors' outside activities which are in business competition with the company, (3) require that approval of any such activities be subject to the same standards as approval of other activities which involve a director's duty of loyalty, and (4) allow such approval by either the board or the shareholders.

The provision which has been suggested would state, simply, that a director may not directly or indirectly engage in "business competition" with the company unless one of three circumstances is applicable:

(a) there is no reasonably foreseeable harm to the company from the competition,
(b) the competition is authorized by majority vote of disinterested members of the company's board of directors acting in accordance with the standards governing approv-

al of other interested-director actions which are discussed and suggested above in section 3 of this article, or
(c) the competition is authorized by majority vote of disinterested shareholders.

Macedonian lawyers have pointed out that the above wording requires a subjective judgment as to when a director's activities do or do not involve "business competition" and that, therefore, it may actually be preferable for the law to require a director to disclose, and obtain board or shareholder approval of, *all* of the director's activities outside the company, as the present LTC provisions contemplate. It has further been argued that full disclosure of this kind is especially needed in transition countries where there is limited business transparency. The author's view is that such judgments - while admittedly subjective - should not be hard to make since they are based on concepts of basic fairness. Furthermore, it can be intrusive (to the director) and burdensome (on the company) to require review of each and every outside director activity. To require such a thing can invite evasion by a director, can discourage qualified persons from serving as directors and can, as a consequence, discourage outside investment. This may continue as an open issue as the meetings on revision of the LTC proceed.

Conclusion

The above discussion shows that it is easy to criticize the present Macedonian law, but such criticism, and the law revision process which is now going forward, should be seen in context. At the end of the Socialist period Macedonia, like many of its neighbor countries, had an almost immediate need for new and comprehensive business laws in many areas - not only company law but also securities law, collateral and mortgage law, bankruptcy law, obligations law and accounting standards law, to name just a few. Macedonia responded quickly with a large corpus of new laws which included the LTC and which have served well through the 1990s to today. These are the laws which are now called the "first generation". It was inevitable that with experience and with increasing foreign investment the time would come for revision of those laws. Macedonia is very fortunate to have an active bar and judiciary participating in this process, and it is hoped that the suggestions made above will be a useful contribution.