



LEGAL FRAMEWORK: LIABILITIES OF BOARD MEMBERS IN THE BALTICS AND THE EFFECT OF ESG THEREON

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✓ **BOARD MEMBERS' DUTIES
OR STANDARD OF CARE**

BOARD MEMBERS' DUTIES OR STANDARD OF CARE (1/2)

Applies to

- Members of Management Board and Supervisory Board in Latvia
- Members of Management Board and Supervisory Board in Estonia
- Managing director, Management Board and Supervisory Board members in Lithuania

BOARD MEMBERS' DUTIES OR STANDARD OF CARE (2/2)

The duties of Board members include

- Duty to act with due diligence
- Duty to act in good faith
- Duty to act pursuant to law and the company's articles of association
- Duty to act pursuant to lawful decisions of other managing bodies of the company
- Duty of loyalty

DUTY TO ACT WITH DUE DILIGENCE (1/2)

Board members are required to perform their obligations with such due diligence as would be applied by a prudent manager in the same circumstances

- Not just a prudent person, but a prudent manager (**higher standard** – average, reasonably experienced business leader, while the subjective circumstances – experience and knowledge of the particular person would be also taken into account by courts)
- Comparable circumstances (including available resources, economic state of the particular company, etc.)
- *Business judgement rule, Lithuania*

DUTY TO ACT WITH DUE DILIGENCE (2/2)

Duty to act with due diligence means

- The duty to be diligent – the responsibility follows even in case of negligence, not only fault (**scope of duties is currently increasing with movement towards sustainability - note the upcoming legislation on non-financial reporting and supply chain due diligence; regulation on disclosures for financial sector**)
- The duty to be sufficiently informed for making decisions (requires having a sufficient control over company's affairs and objective evaluation of circumstances, including, involvement of experts)
- The duty to restrain from taking unnecessary risks to the company (the risks taken should not be obviously unjustified)
- **Includes the duty to set up appropriate control & risk management system**

DUTY TO ACT IN GOOD FAITH

- Closely related to the duty of loyalty
- Means the duty to apply all the possible due diligence to act in the interests of the company, the shareholders (as a whole), creditors, employees, general public interest **(note the movement from shareholder to stakeholder approach)**
- Duty of equal treatment of all shareholders
- For example, credit institution laws establish a duty to act in the interests of the clients

DUTY TO ACT PURSUANT TO THE LAW AND THE ARTICLES OF ASSOCIATION

Includes, inter alia

- Duty to adhere to the company's aims established in the articles
- Duty to provide information (in the required amount) to the shareholders and other bodies, especially in case of worsening of financial situation of the company
- Duty to submit insolvency application
- Duty to receive consent of other managing bodies for certain type of transactions
- Duty to call a shareholders' meeting

DUTY TO ACT PURSUANT TO LAWFUL DECISIONS OF OTHER MANAGING BODIES

- A Board member has to adhere to decisions of superior bodies, like the Supervisory Board or a general meeting of shareholders
- However, **a Board member is always required to evaluate such decisions and only adhere to them if the decisions are compliant with applicable laws**
- Acting according to a resolution of a general meeting
- Lithuania: AB «Barklita» case
- Latvia: special provisions in the Law on Groups of Companies

DUTY OF LOYALTY (1/2)

Includes, inter alia

- **General duty to avoid conflicts of interests and not prefer Board member's own interests over the interests of company (shareholders, employees, creditors, etc.)**

Specific duties

- Duty to inform on possible interests of conflict
- Non-competition (during the term of the office)
- Duty to preserve business secrets (as long as the company has a justifiable interest in keeping such secret /during the term of office)

DUTY OF LOYALTY (2/2)

- Duty to receive consent for transactions between the company and the Board member (directly or indirectly) or inform about such transaction immediately after conclusion
- Voting restrictions

✓ **RESPONSIBILITY
OF A BOARD MEMBER**

KINDS OF LIABILITY

- Board member liability under commercial laws
- General civil liability for damages (tort)
- Administrative liability
- Criminal liability

BOARD MEMBERS' LIABILITY UNDER COMMERCIAL LAWS (1/5)

- ✓ Board members who cause damages to the company in violation of their duties are liable for such damages with all of their property

Criteria for liability

- Existence of a breach of a duty
- Loss incurred to the company and the causal link between the loss and the breach of the duty
- Board member may not prove he has acted with due care (**the burden of proof lies on the Board member**)
- Liability is joint and several

BOARD MEMBERS' LIABILITY UNDER COMMERCIAL LAWS (2/5)

Claimant	Latvia	Estonia	Lithuania
Company	Yes (GM with simple majority vote or insolvency administrator)	Yes (GM with simple majority vote or bankruptcy trustee)	Yes (Board/director or bankruptcy administrator)
A shareholder	Shareholder representing at least 5% votes or shareholding at least EUR 71,100	No	Any shareholder
A creditor, for the benefit of the company	Yes (if unable to satisfy claim from the company)	Yes (if unable to satisfy claim from the company)	Yes
A creditor, for their own benefit	No (except reorganization or on other grounds/ after insolvency)	No (except on other grounds)	No (except on other grounds / after insolvency)

BOARD MEMBERS' LIABILITY UNDER COMMERCIAL LAWS (3/5)

Term for bringing a claim

Latvia	5 years	<ul style="list-style-type: none">• An agreement with shareholders/company on a different term possible, not binding to creditors, insolvency administrators• 10 years for claims originating before July 2017
Estonia	5 years	<ul style="list-style-type: none">• A different term can be provided in articles/agreement, but, if shorter, not binding to creditors and bankruptcy trustee• 3 years in case of breach of non-compete obligation• 10 years in case of intentional breach
Lithuania	3 years	<ul style="list-style-type: none">• A different term can be agreed, but would not be binding in case of gross negligence

BOARD MEMBERS' LIABILITY UNDER COMMERCIAL LAWS (4/5)

Exceptions to liability

- **Latvia and Estonia:** lawful decisions of general meeting, a waiver of a specific claim by a general meeting of shareholders (the breach and the related damage must be sufficiently disclosed) (the waiver or decision not to sue not binding to creditors/bankruptcy administrator)
- **All countries:** an agreement with the company/shareholder

BOARD MEMBERS' LIABILITY UNDER COMMERCIAL LAWS (5/5)

Possible additional consequences to a breach

- Recognition of transactions concluded in breach of non-competition obligation as concluded with the company and the transfer of respective income/benefit to the company (Latvia, Estonia)
- Annulment of transactions in case of insolvency (Latvia, Estonia, Lithuania)
- Personal liability for tax debts and personal liability to creditors in case of insolvency (Latvia)
- Personal liability for an obligation towards a creditor in case of excess of authority (Lithuania)
- Provisions on investigation of directors' activities (Lithuania)

SOME OF THE MOST POPULAR MYTHS ABOUT BOARD LIABILITY

- General release from liability upon approval of annual reports works
- Avoiding taking a decision helps avoiding liability
- Avoiding knowing about an issue helps avoiding liability
- Division of liability among Board members means you are only responsible for your own area
- Approval by Supervisory Board or general meeting always helps avoiding liability
- Re-registering your property (usually to a family member) shortly before or after receiving a claim regarding Board member's liability helps

✓ **A TOOLBOX FOR
STAYING ON THE «SAFE SIDE»**

A TOOLBOX FOR STAYING ON THE «SAFE SIDE» (1/2)

- Don't agree to be in a Board if you are not actually and actively involved in the company's governance
- Don't agree to be in a Board if there is no **trust**
- **Be aware** of what is going on in the company, even outside your direct responsibilities
- Establish **clear reporting systems** to keep you aware
- Report to your supervisors on regular basis even if not asked (**too much information is better than less**)
- Establish clear internal rules within the Board, between the Board and the shareholders, and between the Board and other key managers
- **Document** all your activities in case of any sensitive/important matters

A TOOLBOX FOR STAYING ON THE «SAFE SIDE» (2/2)

- Find a good amount of people you may consult with
- Get **insurance** and be careful about it
- Ask for shareholders' decision on issues you cannot take responsibility for
- Ask for **special agreements** regarding liability towards the company and shareholders
- Sometimes resignation letters are submitted too late



Q & A

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