The Fiduciary Duties of Directors In "Twilight Zone" of Insolvency Under Colombian Law

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Bankruptcy does not usually occur suddenly. As the business starts to deaccelerate—suppliers and creditors become anxious and the market becomes aware of the red flags—directors may act desperate to "keep the boat afloat." The big question they face is whether in such distress the beneficiaries of the fiduciary duties become the creditors, instead of the shareholders.

Colombian bankruptcy law, Law 1116 of 2016 ("Law 1116") does not have a straightforward answer, but does hint at the special consideration that directors must give to creditors in the twilight of insolvency.

General Liability Rules

Colombia's Code of Commerce provides that directors are jointly and severally liable for the losses they cause to the company, its shareholders or third parties. In this regard, director liability requires proof of (i) negligent or willful misconduct on the part of the director, (ii) a loss to the plaintiff, whether plaintiff is a creditor, shareholder or a third party and (iii) causation.[1] The burden of proof is on the plaintiff with respect to all the elements of the cause of action, unless the director or officer's conduct is in violation of the law, in which case negligence is presumed.[2]

If, however, the director—particularly as a board member—(i) has no knowledge of the decision that will result in the action or omission that causes the plaintiff's loss, or (ii) votes against such decision, and provided that, in either case, the relevant director does not take any action to implement the approved action or omission, such director will not be liable vis-à-vis the company, its shareholders or third parties.[3]

The above rules are generally construed as liability rules (i.e. tort rules), which means that, unless otherwise specifically set forth in the law, their application is subject to the general tort principles of loss and causation. This is relevant to the extent that, pursuant to such principles, it is the person causing the harm who will be liable. It is therefore the director who approved or implemented a damaging decision that caused the plaintiff's loss, and not necessarily the current director or group of directors in office at the time the action is brought before the Court, who will be liable vis-à-vis the company, its shareholders or third parties. The fact that a director resigns, for example, should have no bearing on such director's liability for the decisions he or she approved or implemented prior to resignation.

Director Liability Regime in Insolvency

Directors are also liable for the damages caused to the company's property when the company is subject to an insolvency proceeding.[4] Claims against directors within insolvency proceedings for damages caused to the company's property must be initiated by external creditors, and the competent authority to decide on these actions will be the bankruptcy judge.

Three points are particularly relevant in this regard: first, a director's financial liability to a plaintiff in this scenario is secondary and may only be brought to bear if, as a result of his or her actions, the company's assets are not sufficient to pay for its external liabilities; second, during bankruptcy proceedings, negligence on the part of the directors is presumed, **provided** that the conduct of the directors is found to be in breach of the law or the company's bylaws; and, finally, this is also a "liability" rule, which, as explained above, will govern the responsibility of a director for the decisions they approved or implemented while occupying the directorship, irrespective of the fact that they may not be a director of the company at the time the action is brought.

The next question, then, is whether or not in an insolvency context directors may also be released from liability if they

Director Liability

		Required Proof	Exemption	Liability
Normal Regime	Subject to general tort principles (loss/causation)	— Negligent/willful misconduct — Loss — Causation	— Absence of knowledge — Vote against action/omission — No action taken to implement action/omission	— Negligent/willful misconduct — Loss — Causation
During Insolvency	Claims must be brought by creditors	— Director negligence is presumed IF there is a breach of law or company bylaws	— Split interpretation re: whether proof director had no means to know or prevent conduct, or director voted against action, exempts them: A. if company property is impaired, director is nonetheless liable B. if director did not approve or was not aware they are exempt	— Financial only to the extent company's assets are insufficient — Punitive (fines)

had no knowledge of, or voted against, a decision which, once implemented, caused a loss to the plaintiff. The answer to this question is unfortunately not straightforward, as there are two possible interpretations of the Colombian law on this point. Pursuant to the first interpretation, directors who had no knowledge of the relevant decision, or who voted against it, are nonetheless liable if, as a result of a board decision, the company's property is somehow impaired and, in consequence, the company's assets are not sufficient to pay for its liabilities. This interpretation stems from the fact that Article 82 of Law 1116, which governs directors' and shareholders' liability within insolvency proceedings, only mentions these grounds of exoneration when referring to the liability of shareholders, which could lead a judge to consider that directors, to the extent not expressly covered by the exception set forth in Article 82, should be liable notwithstanding their lack of knowledge of the decision or their having voted against it. Pursuant to the second interpretation, the absence of a clear rule in Article 82 regarding the liability of directors means that this hypothesis should be governed by the general liability rules applicable to directors (i.e. the liability rules that apply to the directors of a "going concern"), in which case directors would not be liable for decisions they did not approve or of which they were not aware.

However, of note is that the Superintendence of Companies, a government agency responsible for supervising commercial companies in Colombia, when mentioning the level of diligence that directors must employ when exercising their functions within companies undergoing insolvency proceedings, has referred to the following quote:[5]

> *It is not enough, in order to elude joint liability, for board members to prove that they did not participate in the corresponding board meeting; unexcused absence may be qualified as culpable negligence. Board members must prove that there were no means of knowing or preventing the negligent conduct. Honest and prudent directors that prevent lawful maneuvers, do not satisfy with merely voting against, but quit in order to avoid any association with the measure.*

Thus, even if it is accepted that general liability rules are applicable to directors' liability during insolvency proceedings, the bankruptcy court may not exonerate the questioned director, if the director merely proves the absence of knowledge of the decision that resulted in the action, or the omission that caused the plaintiff's loss, or if they voted against such decision. The bankruptcy court may demand more diligent conduct on the part of directors before it will relieve them of their liability, as it did in the MNV S.A. Judicial Liquidation Proceeding, for example.

In addition to the liability regime illustrated above, the bankruptcy court may also impose fines and sanctions consisting of the banning of the director from engaging in any business for up to ten years if it appears that, among others, (i) the company was used to defraud the creditors, (ii) the business was fraudulently driven into insolvency, (iii) the director unjustifiably breached the reorganization plan, (iv) the director speculated with respect to the creditors' claims to purchase them at a discount, (v) the director participated in simulated acts, or altered the financial records, and (vi) the director waived a right or action without reasonable cause.

Conclusion

As a conclusion, although Colombian law does not expressly answer the question on the fiduciary duties of directors before and during insolvency proceedings, the high standards applicable to directors that are embroiled in a bankruptcy proceeding, and the severe sanctions for the breach of such standards, seems to actually impose the observation of fiduciary duties not only to the shareholder, but also to the creditors in the twilight of insolvency proceedings and during the days of distress that make up the insolvency process.

Accordingly, creditors must be aware of the actions that may be brought against directors for the damages caused due to their negligence or misconducts, particularly during insolvency proceedings, where the acts of the directors may be the direct cause of the distress. ■

1. Corte Suprema de Justicia [*Supreme Court of Justice*], Cas.Civ. Exp. 9879 (2005) (Col.).
2. When negligence must be proved, evidence of ordinary negligence will suffice; there are no special or deferential standards requiring evidence of gross negligence or willful misconduct.
3. Corte Suprema de Justicia [*Supreme Court of Justice*], Cas.Civ. Exp. 9879 (2005) (Col.).
4. Law 1116, Article 82.
5. *Cf.* Superintendence of Companies, MNV S.A. Judicial Liquidation Proceeding, Writ from August 21st, 2012; Superintendence of Companies, Gas Kapital GR. S.A. Judicial Liquidation Proceeding, Writ from August 8th, 2012.
6. Law 1116, Article 83.

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