STANDARD STRATEGY: the DUTY OF LOYALTY

Duty of loyalty = fairness standard

The duty of loyalty stands for the principle that directors and officers of a corporation in making all decisions in their capacities as corporate fiduciaries, must act without personal economic conflict.

Every director and officer of a corporation must act in good faith, in the best interests of the corporation. Given the fiduciary nature of their position, they must be careful not to exploit opportunities they become aware of because of their position with the corporation.

The duty of loyalty can be breached either by making a self-interested transaction or taking a corporate opportunity.

Unfair related-party transactions are unlawful and courts determine their unfairness ex post

How burden of proof is allocated influences the effective protection of shareholders:

Delaware = defendant must prove fairness

In the other countries = plaintiff must prove unfairness

Enforcement varies in terms of:

strictness of courts in evaluating ex post

compliance mechanisms (actions)

remedies (nullity, damages, etc.)

redress (for shareholders [non listed companies])

For nearly two centuries, a cornerstone of Anglo-American corporate law has been the fiduciary duty of loyalty, the most demanding and litigated fiduciary obligation imposed on corporate managers.

The duty—which regulates financial conflicts of interest and requires managers to subordinate their own interests to the corporation's—represents a key policy lever to address the most pernicious of intra-firm agency costs.

Beginning in 2000, Delaware dramatically departed from longstanding tradition, amending its statutes to enable corporations to waive a critical component of loyalty—the corporate opportunity doctrine (*legal principle providing that directors, officers, and controlling shareholders of a corporation must not take for themselves any business opportunity that could benefit the corporation. The corporate opportunity doctrine is one application of the fiduciary duty of loyalty*)—which forbids corporate fiduciaries from appropriating new business prospects for themselves without first offering them to the company.

From that moment forward, Delaware corporations and managers were free to contract out of a significant portion of the duty of loyalty. In the ensuing years, several other states have followed Delaware's lead, granting their own incorporated entities the statutory authority to execute corporate opportunity waivers (COWs).

Waiver of Corporate Opportunity. (a) To the fullest extent permitted by applicable Law, the Company hereby agrees that the Exempted Persons shall not have any obligation to refrain from engaging directly or indirectly in the same or similar business activities or lines of business as the Company or any of its Subsidiaries. To the fullest extent permitted by applicable Law, the Company, on behalf of itself and its Subsidiaries, renounces any interest or expectancy of the Company and its Subsidiaries in, or in being offered an opportunity to participate in, business opportunities that are from time to time available to the Exempted Persons, even if the opportunity is one that the Company or its Subsidiaries might reasonably be deemed to have pursued or had the ability or desire to pursue if granted the opportunity to do so. The Company hereby further agrees that, subject to Section 4.6(b), each Exempted Person shall have no duty to communicate or offer such business opportunity to the Company (and that there shall be no restriction on the Exempted Persons using the general knowledge and understanding of the Company and the industry in which the Company operates that it has gained as an Exempted Person in considering and pursuing such opportunities or in making investment, voting, monitoring, governance or other decisions relating to other entities or securities) and, to the fullest extent permitted by applicable Law, shall not be liable to the Company or any of its Subsidiaries or stockholders for breach of any fiduciary or other duty, as a director or officer or otherwise, solely by reason of the fact that such Exempted Person pursues or acquires such business opportunity, directs such business opportunity to another person or fails to present such business opportunity, or information regarding such business opportunity, to the Company or its Subsidiaries, or uses such knowledge and understanding in the manner described.

Substantive vs. Procedural Fairness

Courts applying a fairness standard evaluate both:

- **Fair dealing (process):** how the transaction was initiated, structured, negotiated, approved, and disclosed.
- **Fair price (substance):** economic fairness and whether the terms align with what would have been obtained in an arm's-length transaction.

Many jurisdictions (especially Delaware) require satisfying **both elements** for the transaction to be considered "entirely fair".

DUTY OF LOYALTY

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DIRECTORS AND OFFICERS

- all jurisdictions encourage independent directors to monitor related-party transactions and compliance with duty of loyalty

- standard strategy operates in conjunction with trusteeship strategy

- US = fair related-party transactions to be preapproved by the independent directors

- US = the RPT is fair if “at arm’s length”

Burden of Proof Allocation

- In **Delaware**, defendants (directors/officers) must prove the **fairness** of the transaction if procedural protections are absent.
- In other jurisdictions, the burden typically falls on **plaintiffs**, who must prove the **unfairness** of the RPT.

This divergence deeply affects the **effectiveness of the duty of loyalty** as a protective mechanism for minority shareholders.

- Europe-Japan = rarely question fairness of transactions and directors are unlikely held responsible for breaches of the duty of loyalty

REASONS: discovery rights, fees and other favourable tools are greater in US!

Reasons for Stronger U.S. Enforcement

U.S. litigation is facilitated by:

- Extensive **discovery rights**
- **Contingent fees** for plaintiffs’ attorneys(1)
- **Generous fee-shifting awards**
- Absence of a **loser-pays rule**

These structural features create a highly active plaintiffs’ bar and significantly increase the likelihood of judicial review of related-party transactions.

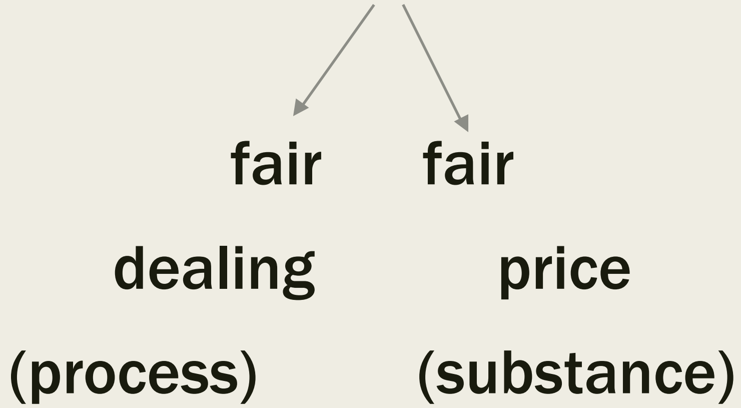
(1)In minority shareholder litigation, contingent fees function as a private enforcement tool that mitigates the collective action problem by enabling shareholders with small stakes to bring derivative or class actions without bearing prohibitive costs. The mechanism is central to U.S. corporate law but largely absent in civil-law systems.

DUTY OF LOYALTY

CONTROLLING SHAREHOLDERS

controlling shareholders can be found responsible for having engaged in unfair self-dealing transactions

US adopts the toughest standards (entire fairness test)



fair dealing (process)

fair price (substance)

Europe, Brazil and Japan = these jurisdictions are reluctant to hold controlling shareholders liable unless they become involved in the corporate affairs (de facto or shadow directors are then considered as ordinary directors and so exposed to liabilities)

Forms of Control Relevant for Liability

Courts may hold controlling shareholders liable not only when they exercise **formal** control but also when they operate as:

- **De facto directors**, or
- **Shadow directors** (i.e., giving instructions that directors routinely follow).

These situations expose controllers to the same fiduciary obligations as directors.

DUTY OF LOYALTY

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GROUPS

Groups normally enter into related-party transactions and the efficiency of the group relies on such transactions

Legitimately subsidiaries pursue the group’s interest, as decided by the controlling company, rather than their own

An alleged damage caused by unfair transactions involving a subsidiary cannot be judged individually but only taking into account the overall operations with the controlling company which may have offset such damage

Minority shareholder can challenge the unfair management of the parent company

Germany = applies simple fairness standard = indemnification of subsidiaries by parent, otherwise derivate actions

Italy = considers the overall fairness ex post

France = requires i) stable structure of the group, ii) coherent group policy, iii) equitable intra-group distribution of costs and revenues.

Comparative Approaches to Group Transactions

- **Germany:** Applies the most elaborate statutory group law (Konzernrecht); allows parent companies to instruct subsidiaries but requires **indemnification** for any losses.
- **Italy:** Treats the subsidiary as a **business unit** and evaluates group transactions ex post based on the **overall results** of the parent's management.
- **France:** Most flexible; allows sacrifice of subsidiary interests if the group has a **coherent policy** and **equitable allocation of costs and revenues**.
- **United States**: No comprehensive statutory group law; corporate separateness is formally preserved, and abusive group transactions are policed ex post through fiduciary-duty litigation, veil-piercing and substantive-consolidation doctrines, typically via derivative or class actions brought by minority shareholders.
- **United Kingdom**: Also follows an entity-by-entity model; intra-group and related-party dealings are constrained by directors' duties to each company, detailed related-party transaction rules in the (reformed) UK Listing Rules, and strong minority remedies such as unfair-prejudice petitions and derivative claims.
- **Japan**: Lacks a dedicated statutory group law; parent–subsidiary transactions are governed by Companies Act conflict-of-interest rules and stock-exchange governance codes, with increasing reliance on independent directors and minority-shareholder protections for listed subsidiaries within corporate group.
- **Brazil**: Adopts an explicit grupo de sociedades regime under the Corporations Law: a parent and its controlled companies may enter into a group convention centralizing management, but the parent owes compensation for harmful group policies and can be sued by minority shareholders for abusive use of control and unfair related-party dealings.

These models illustrate how jurisdictions balance **group efficiency** with **minority protection**.

ENFORCEMENT OF STANDARD STRATEGY

- Greater enforcement in US: courts often review fairness of transactions = facilitation of shareholders lawsuits.

- US laws facilitate shareholder suits: contingent fees, discovery rules, pleading rules, big attorney’s fee awards, no loser pays rule

- private/public enforcement outside US is more complicated: minimum ownership thresholds and procedural obstacles

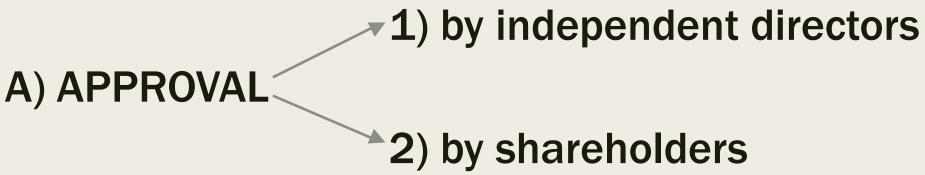
Private vs. Public Enforcement Mechanisms

- In the **U.S.**, enforcement is mainly **private**, through shareholder litigation, with courts deeply reviewing fairness.
- In **continental Europe, Brazil, Japan**, minority shareholders face statutory and procedural obstacles (e.g., minimum ownership thresholds), making litigation **rare**.
- Public authorities (e.g., CONSOB in Italy, AMF in France) increasingly play an active role in ensuring compliance.

The role of the Securities Authorities in enhancing RPT fairness enforcement

OWNERSHIP REGIMES AND RELATED-PARTY TRANSACTIONS

- all jurisdictions, excepted US, have more lenient approach towards transactions with controlling shareholders than with managers



A) APPROVAL

1) by independent directors

2) by shareholders

B) DISCLOSURE + NO INSIDER TRADING (only for listed companies)

(shareholders have interest in long term firm’s performance)

- where ownership is dispersed: more risks of managerial transactions

Impact of Ownership Patterns on Enforcement Intensity

- In **concentrated ownership systems** (continental Europe/Brazil): enforcement focuses on **controlling shareholders** and their potential for expropriation.
- In **dispersed ownership systems** (U.S. and U.K.): enforcement is more concerned with **managerial conflicts**, including self-dealing and compensation-related RPTs.

Enforcement intensity also correlates with the strength of **institutional investors**, **plaintiffs’ bar**, and **securities regulators**—all particularly robust in the U.S.

- where ownership is concentrated more risks of related-party transactions with controlling shareholders

- the pattern of the legal constraints on related-party transactions follows the structure of the ownership: more constraints on managers in US-UK-JAPAN, more constraints on controlling shareholders in Germany-France-Italy

- regulatory strategies have strong relationship with ownership regime

- disclosure is more demanding in US and UK, now becoming stronger also in continental Europe due to competition to allure institutional equity investors

- approval requirements: relies on board approval of transactions with top managers

Are directors really independent?

Germany + Italy + Brazil: leave to directors/managers judgment

France + UK: leave to directors + shareholder for non routinary transactions

US + Japan: leave to directors + judicial review

Enforcement via shareholders lawsuits:

- strong in US
- public enforcement in other jurisdictions

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expected to increase in the next years

Competition between private and public enforcers increases the overall level of enforcement.

Key Takeaways

- The duty of loyalty operates differently across jurisdictions, shaped by procedural tools, enforcement structures, and ownership patterns.
- U.S. law stands out for the rigorous fairness review and strong litigation infrastructure supporting minority enforcement.
- Civil-law systems rely more on **public enforcement**, **ex post review of overall fairness**, or **group-law doctrines**.
- The ownership regime (dispersed vs. concentrated) is the most powerful factor explaining cross-country differences in the regulation of related-party transactions.