

Trend and Implications of Recent Decisions on Directors' Duty to Monitor and Supervise

I. Directors' duty to monitor and supervise

A director (registered director) of a company have a fiduciary duty to the company. Article 382, Paragraph (2) of the Commercial Act stipulates that the provisions of the Civil Act on delegation shall apply *mutatis mutandis* to the relationship between a company and its directors, and Article 681 of the Civil Act provides that a delegatee shall have a duty to manage the affairs delegated to him/her with the care of a good manager in accordance with the tenor of the mandate (*i.e.*, a fiduciary duty).

One of such fiduciary duties, as acknowledged by the Korean Supreme Court, is the “duty to monitor and supervise.” It is a duty of a director to monitor the performance of other directors, in addition to performing his/her own duties; a director shall not only comply with applicable laws himself/herself, but also monitor and supervise other directors so as to ensure that they comply with applicable laws in performing their duties (see, *e.g.*, Supreme Court Decision No. 2017Da222368 rendered on November 11, 2021).

II. Trend and implications of recent decisions that applied a stricter standard regarding directors' duty to monitor and supervise

The Supreme Court recently applied a stricter standard regarding directors' duty to monitor and supervise. Below are two Supreme Court key precedents that illustrate this trend.

1. Supreme Court Decision No. 2017Da222368 rendered on November 11, 2021

Supreme Court Decision No. 2017Da2222368 rendered on November 11, 2021 concerned directors' duty in a case where a company was subject to administrative fines imposed by the Korea Fair Trade Commission (KFTC)

for acts of market collusion. In this case, the court ruled that “the defendant, who is the representative director, cannot be exempt from liability solely on the grounds that he was unaware of the schemes in detail and that he did not directly instruct the executives to engage in such illegal acts. If the defendant continued to neglect his duty to monitor as the representative director, and as a result, caused damage to the company, the defendant should be held liable for such damage.” The court also noted that “the internal accounting management system, which the defendant argued that had been established as an internal control system for the preparation and disclosure of accounting information under the Act on External Audit of Stock Companies, is generally limited to accounting, and the code of ethics enacted in 2003 is nothing more than an abstract and comprehensive guideline on the performance of duties by officers and employees, and thus it is difficult to deem that the appointment and operation of outside directors and auditors, and decision-making through the board of directors, as alleged by the defendant, actually served as means to prevent illegal acts such as price-fixing, collect and report information on suspected or confirmed illegal acts, or further control illegal acts.”

The foregoing Supreme Court shows that, in relation to directors' duty to monitor and supervise, directors shall make efforts to establish an internal control system and perform their duty to monitor and supervise the overall affairs of the company using the established system. In particular, the internal accounting management system under the Act on External Audit of Stock Companies, etc. or an internal code of ethics alone cannot be deemed a sufficient internal control system.

2. Supreme Court Decision No. 2021Da279347 rendered on May 12, 2022

Supreme Court Decision No. 2021Da279347 rendered on May 12, 2022 concerned a shareholder derivative

lawsuit that was filed against the representative director and directors for failing their duty to monitor in relation to the company's practice of bid-rigging in the market. Although the trial court held that only the representative director breached his duty to monitor, the Supreme Court upheld the appellate court's decision recognizing that the other directors and outside directors, in addition to the representative director, also breached their duty to monitor.

In this case, the shareholders of the company filed a shareholder derivative lawsuit against the then-representative director and directors including outside directors of the company for damages in the amount of the KFTC's administrative fine imposed on the company resulting from its practices of bid-rigging in the market.

The trial court held that only the representative director breached his duty to monitor the company's officers and employees.

However, the Seoul High Court, the appellate court, expanded the scope of liability to recognize that the other directors also breached their duty to monitor and supervise. It ruled that "even if the defendants (the directors including the outside directors) were unaware of, could not have been aware of, or had no circumstance to suspect bid-rigging because they were not involved in or reported to on the bidding for individual construction projects, they breached their duty to monitor by failing to establish a reasonable information and reporting system and an internal control system that may have caught these illegal bid-rigging acts by the officers and employees and to fulfill their duty of care to ensure that such system works properly."

In this regard, the Supreme Court dismissed the appeal and affirmed the lower court's decision. In addition, it set out the criteria for determining whether outside directors have breached their monitoring duty by explaining, "however, in the case of outside directors who are not in charge of the company's business affairs, they may be recognized to have breached their duty to monitor if they (i) have failed to make any efforts to call for the establishment of an internal control system where the company does not have any such system in place, or (ii) even if the company has an internal control system, the outside directors have ignored or neglected circumstances to suspect that it is

not being operated properly." The Supreme Court added, "in a case where a director is liable for damages to his/her company arising from his/her violation of laws, regulations or the company's articles of incorporation by willful misconduct or negligence, or negligence in performing duties, the amount of damages may be limited in light of the guiding principle of the damage compensation system—i.e., equitable apportionment of damages. In doing so, the overall circumstances, including the following, shall be taken into account: (i) the substance and nature of the business; (ii) the circumstances leading up to and specific aspects of the director's breach of duties; (iii) the objective circumstances and degree of the director's involvement in the occurrence and aggravation of the damage; (iv) the director's usual contribution to the company; (v) whether the director benefited from the breach of duties; (vi) whether there exists any defect in the company's organizational system; and (vii) whether a risk management system has been established. In this case, it is the prerogative of the trial court to find facts relating to the grounds for limiting the damages amount or determine the ratio of limitation, unless it is significantly unreasonable in light of the principle of equity (see, e.g., Supreme Court Decision 2007Da34746 rendered on October 11, 2007)." This decision reaffirmed the consistent view of the existing Supreme Court precedents and upheld the lower court's decision that limited the director's liability for damages in light of the overall circumstances.

The Supreme Court's rulings above made the Supreme Court's position even clearer: even directors (including outside directors), let alone the representative director, can be held liable for breaching their duty to monitor through an internal control system, even if they were unaware of, could not have been aware of, or had no circumstance to suspect bid-rigging.

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