The best tips for preventing directors' liability under Dutch law

Marlies Siegers

"With integrity, you have nothing to fear, since you have nothing to hide. With integrity, you will do the right thing, so you will have no guilt."
[Zig Ziglar]

Anyone running a business must be able to actually do business – this is a principle that is given great weight by the Dutch legislature, and is a central theme in Dutch liability law. Directors of companies must have the freedom to try to turn opportunities into successes. Dutch law fully endorses the freedom of directors of companies: the bar for directors' liability is high. Directors should not be unnecessarily frightened or risk-averse. Taking responsible risks also means that there is a chance of failure. If things go wrong, creditors can hold the company liable; the directors are not liable, or at least only in exceptional situations. This is good for directors, particularly in financially uncertain times. It is less attractive for creditors: they are usually left empty-handed if the company goes bankrupt. That is the other side of the freedom that the law grants to directors.

Just like in real life, this legal freedom is not unlimited. So where does Dutch law draw the line? In what situations can directors be held liable with their private assets? Who can hold directors liable? What tests are applied to determine whether the directors have conducted legally responsible management? How can potential risks be reduced? This article is limited to directors of Dutch private and public limited liability companies, and contains a brief sketch of Dutch law: an exploration of the many-coloured palette of legal risks inherent in doing business.

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Being able to present a convincing factual narrative is exactly what makes the difference in litigating directors' liability.

Who can hold a director liable and on what grounds?

A director can be held liable for his[1] actions by "internal" or "external" actors. Therefore, a distinction is made between "internal" (vis-a-vis the company) and "external" (vis-a-vis third parties) liability of directors. Below are some examples of internal and external grounds for directors' liability:

1. Directors can of course be male, female, or non-binary. For brevity (although readily admitted: not necessarily inclusive) the director is referred to in the 'he' form here. This reference is intended to include directors of all genders.

Internal directors' liability:	**External directors' liability:**
The company or (after the company's bankruptcy) the bankruptcy trustee holds the director personally liable.	Creditors, the bankruptcy trustee, the Tax Receiver and/or shareholders hold the director personally liable.
Article 9 of Book 2 of the DCC[2]: liability for loss or damage caused by improper performance of duties (see explanation below).	Article 162 of Book 6 of the DCC; liability for loss or damage caused by a tort (see explanation below).
Other forms, such as liability for dividend payments and reductions of capital.	Article 148/248 of Book 2 of the DCC (only possible for the bankruptcy trustee): liability for manifestly improper management (see explanation below).
	Article 36 of the Collections Act / Article 23 of the Act on Mandatory Participation by Industry Pension Fund (only possible for the Tax Receiver / industry pension fund): liability for particular unpaid tax debts / industry pension fund participation due to manifestly improper management.
	Other forms, such as liability for misrepresentation of the company's financial condition, prospectus liability, liability for legal acts performed before the legal entity's incorporation or its registration in the trade register.

2. DCC = Dutch Civil Code.

Being held liable by the company: not only in cases of fraud or intent

Directors are required to perform their duties “properly”. This standard sounds vague, and in fact it is. What is “proper” depends on the “circumstances of the case”, a legal concept favoured by lawyers but despised by the business sector. You could dismiss this concept as legal hair-splitting, but in this context, it is necessary to speak out in favour of the lawyers. For example, the proverbial greengrocer around the corner requires a different interpretation of a director’s duties than an international high-tech company. The law prescribes that the directors, when performing their tasks, must be guided by “the interests of the company and its associated business”. If the duties with which the board of directors is charged in the specific case are not fulfilled properly, there may be grounds for directors’ liability.

The management duty can be divided among multiple board members. However, each board member remains responsible for the general state of affairs. The relevant features of liability for improper performance of duties can be summarized as follows:

Directors' liability for improper performance of duties	
Collective liability of board members.	All board members are jointly and severally liable – exculpation of an individual board member is sometimes possible if the individual board member cannot be blamed, particularly in view of the internal division of duties among the board, and if the board member has not been negligent in taking action.
Serious blame.	Negligence is not sufficient here. The test is whether the board member acted as may be expected from a board member who is capable of carrying out his duties and performs them conscientiously. There must be serious blame on the part of the director personally, judged according to all the circumstances of the case, such as the division of duties among the board, the nature of the activities carried out by the company, the risks generally arising from them, any guidelines applicable to the board, the information that the board member had or should have had at the time of the decisions or conduct for which he is held to blame, and the understanding and care which may be expected from a board member who is capable of fulfilling his role and performs his duties conscientiously. As a rule, violation of a statutory or regulatory provision intended to protect the company will constitute serious blame.

Because the criterion of “serious blame” is interpreted according to the flexible but vague standard of “the circumstances of the case”, practice shows a wide variety of situations in which the “serious blame” concept has been adopted. Some cases speak for themselves: the situation where a director issued false invoices in order to supplement his income at the company’s expense is an obvious (and real-life) case of fraud which will establish director’s liability. But cases that are perhaps not immediately obvious could also lead to liability, even if there is no intent involved. For example, think of a hasty decision – however understandable it may be – that involves major financial risks, or lack of proper supervision of the risk management function. The line between taking responsible risks and fulfilling the criterion of “serious blame” is not clearly defined, but the addition of “serious” shows that liability is not easily assumed.

There is, however, an additional snag: the question of whether a director is liable or not will ultimately need to be decided in court. The court will always pass judgement retrospectively, and assess whether the board had acted correctly at the time. This entails the risk of the court wrongly placing the director on a level playing field with the benefit of hindsight, and looks at the situation as it existed at the time with the current judicial wisdom (which does not always correspond to the perspective of someone running a business). It is easy to look back and identify the sore spot. That is not allowed, however, and it should not happen, but the tendency is there. That is why we urge directors to record as many details as possible in writing, for example in the minutes of board meetings. Preparing carefully and being able to put forward facts to substantiate the perspective and circumstances in which they acted might make all the difference in court. And making that difference is precisely what we love most about our profession.

Tortious conduct by the board: a serious reproach

Sometimes the consequence of taking a risk is that the company cannot fulfil its obligations. Should the board members then pull out their wallet?

No, fortunately not. At least, not in most cases. The Dutch legal system guarantees that legal entities (companies) can and may participate in legal transactions. The reason for this is particularly to avoid personal liability. For that reason, if the company fails to comply with an obligation or commits a tortious act and offers no recourse, only the company is liable for the resulting loss or damage. The company’s directors are not liable with their private assets.

However, in some specific circumstances it is possible for a director to become liable, and a trustee in bankruptcy, creditors, the Tax Collector and in exceptional cases also shareholders may hold the director personally liable for the loss or damage that the director caused them. The most important features and situations are, in a nutshell:

Liability of a director in tort	
Individual liability of a director.	No collective liability of the entire board: the individual liability must be established for each individual director.
Example I: an obligation undertaken by a director on behalf of the company.	Liability of the director if the director knows that the company will not be able to meet its obligations and will not offer any recourse for the resulting loss or damage.
Example II: frustration by the director of possibilities for recourse against a company with regard to an existing obligation of the company.	Liability of the director if the director knows that actions or omissions of the company that are allowed by the director would result in the company's inability to meet an existing contractual or legal obligation or to offer recourse for the resulting loss or damage, or if the actions or omissions are otherwise negligent towards third parties (e.g. by giving promises of payment).
Sufficiently serious personal blame.	The blame must be sufficiently serious, given the obligation of the members of the board of directors to properly fulfil their duties, the nature and seriousness of the breach of standards and the other circumstances of the case. The blame must also be attributable to the specific director.

Especially in the event of bankruptcy or foreseeable payment difficulties, it is sometimes difficult to distinguish clearly between permissible and impermissible management behaviour. Also, errors of business judgement do not necessarily lead to personal liability, but an error that is personally seriously culpable might.

For example, may a director choose which creditors will or will not be paid by the company? The answer is: in most situations he may, since the freedom of the board is paramount. However, in situations where it has been decided that the company will cease operations and there is not enough money to pay all its creditors, affiliated creditors (e.g. group companies) may not be paid with priority. This also applies to payments in which the director has a personal interest (e.g. if the director has given a personal warranty). The distinction between permissible and impermissible payments is not always clear in practice. The guideline remains whether the director's actions, given the circumstances, are so careless towards a creditor that he bears serious personal blame for his acts or omissions.

An interesting scenario is the situation where there is doubt as to whether there is a "debt" (and therefore a creditor). For example, in practice directors often say, "There is no claim at all, the creditor has no leg to stand on," or, "The case is in court, so there is no claim," or, "We have a counterclaim that is many times bigger". Are these arguments tenable in court proceedings when it comes to directors' liability? Sometimes. As a guiding principle, directors are required to take action as soon as they have to "seriously consider" the existence of the claim. That moment might come, for example, when a judgment is rendered against the company – even if the directors wholeheartedly disagree with the judgment, rightly or wrongly. Required "actions" include recognizing provisions in the annual accounts or withholding cooperation in dividend decisions – even if the dividend decision in itself meets the requirements of company law. Again, our best tip is to record and document these actions and the reasons why certain measures are or are not taken.

Directors' liability in bankruptcy

In the event of a company's bankruptcy, the trustee has an additional tool for holding directors liable for the entire deficit in the estate. Important points to consider include:

Directors’ liability on grounds of manifestly improper performance of duties	
Collective liability of the entire board of directors.	The entire board is jointly and severally liable for the entire deficit in the estate. Dispensation is sometimes possible for an individual board member on the grounds that the improper performance of duties cannot be blamed on that member and the member was not negligent in taking appropriate measures. The court may also moderate the amount of the liability.
Manifestly improper performance of duties during the three years prior to the bankruptcy is a major cause of the bankruptcy.	The criterion is that no reasonable thinking director, given the same circumstances, would have acted as the director in question did.
Breach of an accounting obligation (Article 10 of Book 2 of the DCC) or publication obligation (Article 394 of Book 2 of the DCC): presumptions of evidence.	If an accounting obligation or the obligation to file the annual accounts in the proper time is breached, the improper performance of duties is established (the board cannot refute this anymore) and it is also presumed that this is an important cause of the bankruptcy. The board can refute the latter presumption by making a plausible case that other factors (besides the improper performance of duties) were an important cause of the bankruptcy.

In bankruptcy situations, this is not the only danger that directors might face: the bankruptcy trustee could also bring a claim on account of tortious acts (including, for example, transactions in breach of contract) or on account of the improper performance of duties. Often the trustee will combine the various possibilities in a single action for liability. Creditors may also bring claims on grounds of tort against directors in the event of bankruptcy.

Ten tips for protection against directors' liability

This tour d'horizon shows that in practice legal boundaries are not always clearly defined. The risk of directors' liability cannot always be prevented or eliminated. Therefore, we have the following practical tips:

1. Act in accordance with the company's interests, the law, the articles of association and (where applicable) shareholder agreements – know what these regulations say, and seek advice if in doubt.
2. Ensure careful decision-making and document the facts and circumstances on the basis of which management actions are taken. If in doubt, seek advice.
3. Actively intervene if management duties are not properly fulfilled. Take action to prevent or limit harmful consequences as much as possible.
4. Keep proper accounts and records.
5. Draw up and publish annual accounts on time. Make sure they do not present any misleading information.
6. Do not enter into any commitments that the company is unlikely to be able to fulfil.
7. Take action if there is a serious possibility of a claim against the company, even if the board of directors disputes the company's obligation.
8. Be alert in times of financial difficulty, especially with respect to payments to affiliated companies or payments in which the board has a personal interest. Notify the relevant parties on time of any inability to pay: the tax authorities, the company or industry pension fund, the Institute for Employee Insurance UWV (in Dutch: Uitvoeringsinstituut Werknemersverzekeringen).
9. Every year, ask the general meeting of shareholders to grant the board of directors discharge from liability, and stipulate final discharge from liability from the company and its shareholders in the event of resignation.
10. Take out directors' and officers' liability insurance. An indemnification or warranty by the company or another party might also be a solution but does not always provide effective redress.

Our best and universal tip therefore, as the opening quote but also a Latin proverb indicates, is the following:

Bene agere et nil timere (Do well and fear nothing).

If you have any concerns about potential directors' liability, if you would like to consult about a specific situation, or if you would like to know whether you can sue a director as an unpaid creditor, please contact *Marlies Siegers*.

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You can also visit our website to find out more about the Corporate Litigation & Dispute Resolution team at DVDW.