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NAUTADUTILH

**Directors and Officers Liability
in The Netherlands**

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Directors' and Officers' Liability in The Netherlands

1 Structure of Dutch companies

1.1 A Dutch company is either a private company with limited liability (“*besloten vennootschap*”), hereinafter referred to as a “BV” or a (public) company with limited liability (“*naamloze vennootschap*”), hereinafter referred to as an “NV”. Under Dutch company law several other forms of corporate entities exist, but these will not be discussed in this memorandum. In general, the following distinctions can be made between a BV and an NV:

- (i) Restrictions on transferability of shares. This is the most important difference. The articles of association of a BV must contain a so-called “blocking clause”. In the event that a shareholder wishes to transfer his shares to a third party, this blocking clause must either confer a right of refusal upon the remaining shareholders (“*aanbiedingsregeling*”), or impose a requirement that the transfer be approved by a specific corporate body, such as the General Meeting of Shareholders or the Board of Directors (“*goedkeuringsregeling*”). The blocking clause may also combine a right of first refusal with an approval system. The articles of association of an NV may contain a blocking clause, unless the NV has bearer shares. Only NV bearer shares can be traded at the Euronext N.V Stock Exchange.
- (ii) Types of shares. A BV is authorized to issue only registered shares, which may not be represented by certificates. An NV can have both bearer shares and registered shares. All NV shares, whether in bearer or registered form, may be represented by certificates.
- (iii) Minimum share capital. The minimum issued and paid-up share capital is EUR 18,000 for a BV and EUR 45,000 for an NV.

1.2 There are further differences between a BV and an NV, but in the area of liability of directors these differences are hardly relevant and will not be discussed here.

1.3 When hereinafter reference is made to relevant Sections of the Dutch Civil Code (“DCC”), the first cited Section relates to a BV and the second to an NV.

2 Who are Directors and Officers and what are their responsibilities?

- 2.1** First of all, a summary is provided of the most important rules of Dutch law concerning the powers, responsibilities and liabilities of the members of the Board of Directors of a Dutch company, whether a BV or an NV, which is not subject to a so-called “structure regime”. The structure regime applies to certain “large” BVs and NVs and requires such companies to have not only a Board of Directors but also a Supervisory Board (i.e. a two-tier system). Only a single-tier system will be discussed hereinafter.
- 2.2** Dutch company law does not provide for non-executive members of the Board of Directors. Non-executive Directors are usually members of the Supervisory Board. It is, however, possible for members of the Board of Directors to be in fact non-executive but they have the same responsibilities and liabilities as executive members. There are no nationality or residence requirements for being a Director. Alternate Directors cannot be appointed. The company’s articles of association may fix the number of Directors or simply lay down a minimum number (which may be one). It should be noted that the function of “Officer” is not known under Dutch law. Officers in the Anglo-Saxon systems are normally members of the Board of Directors in the Netherlands.
- 2.3** The Board of Directors manages the company both on a day-to-day basis and for the determination and execution of the long-term policy, subject to the general power of the General Meeting of Shareholders to give directives on policy matters. Especially in situations where the company forms part of a group or is a joint venture vehicle, the General Meeting of Shareholders has power to issue instructions to the Board of Directors which the Board of Directors in turn must execute, unless by doing so it would jeopardize the continued existence of the company. The Board of Directors has no power to appoint its own members. Its members are appointed, suspended and dismissed by the General Meeting of Shareholders.
- 2.4** The Board of Directors must keep adequate records of the company’s business, in particular books of account. It must prepare annual accounts and submit these to the General Meeting of Shareholders for approval and adoption within six months of the end of the financial year. It must file the accounts (or, depending on the size of the company, only the balance sheet) with the Trade Register where the company is registered. This must be done within eight days of the adoption and approval and in any event within thirteen months of the end of the company’s financial year.

- 2.5** In principle, the members of the Board of Directors act as a collectivity. They are all equally responsible and liable for the management of the company. Of course, in practice there is a division of duties and nowadays the Chairman is often the *primus inter pares* or even vested with special powers under the articles of association (i.e. powers to bind the company without joint action on the part of other Directors, or a casting vote at Board meetings). The Chairman often fulfils the function of the Chief Executive Officer in an English or US company.
- 2.6** The powers of individual members of the Board of Directors to act on behalf of the company cannot be restricted by any provision in the articles of association (or in any other document) other than the provisions referred to below (at (i), (iii) and (iv)). Under Dutch company law (which is in line with the First Directive of the EC on company law) the power to bind the company rests with:
- (i) all the members of the Board of Directors acting jointly, and in addition:
 - (ii) either any one individual member of the Board of Directors,
 - (iii) or any member of the Board of Directors specifically designated in the articles of association, e.g. the Chairman and/or the Vice-Chairman,
 - (iv) or two or more members of the Board of Directors acting jointly. These could be two members, e.g. ordinary members, or any such member acting jointly with, e.g. the Chairman. This is the so-called "dual signature system" that is often provided for.

3 Legal Bases of Liability

3.1 A distinction can be made between liability towards the company (internal liability) and liability towards third parties (external liability). Specific liabilities such as environmental and prospectus liability or misleading advertising under Dutch law will not be discussed in this memorandum.

3.2 Internal liability

(a) Section 2:9 DCC

Each Director is obliged to properly fulfil his task vis-à-vis the company (Section 2:9 DCC). Failure to do so will make him internally liable towards the company. In practice this rule is rarely applied. Only if he acts in a seriously negligent manner will the Director be liable. The court will not sit in the chair of the Director when it considers his actions and

omissions. It will ask the question whether a reasonable manager could, on the basis of the facts he knew or could have known at the time, have taken the decision he has taken. Whether a Director has acted in a serious negligent manner will be judged on the basis of the circumstances of the case. Such circumstances could – inter alia – be: (i) the nature of the activities carried out by the company, (ii) the risks generally resulting from such activities, (iii) the division of tasks between the members of the Board of Directors, (iv) the possible directives to which the Directors must adhere and (v) the information which was or should have been at the disposal of the Director at the time of his reproached decisions or actions. Although the Directors may divide tasks between them, they are in principle jointly liable for the entire management of the company. An individual Director may, however, defend himself and prove that he was not to blame for the wrongdoing and that he has not been remiss in taking measures to avert the consequences thereof.

(b) Other company law

There are two other (in practice less important) legal grounds for internal liability of Directors:

- (i) infringement of provisions prohibiting the company and its subsidiaries to subscribe, acquire or hold its own shares (Sections 2:95, 2:207a/98a and 2:207d/98d DCC);
- (ii) liability for the costs of a court ordered inquiry into alleged mismanagement (Section 2:354 DCC).

3.3 External liability

(a) Second Abuse Act

This Act provides for Directors' (personal) liability for the payment of wage tax, VAT, excise tax, social security premiums and contributions to old age pension funds, including interest, costs and penalties, to be made by the company. This liability will only arise if the company is in default of its payments thereof and Directors have failed to report to the authorities as soon as they have found out that the company is unable to pay these taxes or contributions.

(b) Third Abuse Act: Sections 2:248/138 DCC

This Act provides for Directors' external liability in the event of bankruptcy of the company. The Board of Directors shall be held liable, if it has fulfilled its task "obviously improperly" and this is likely to be an important cause of the company's bankruptcy. Pursuant to Section 2:248/138

paragraph 7 DCC policy makers acting as if they were Directors of the company are also regarded as Directors. Dutch law provides that failure to meet the bookkeeping and filing obligations referred to in paragraph 2.4. is obviously improper management and that there is a rebuttable presumption that this is an important cause of the bankruptcy. However, as long as the bookkeeping and filing obligations are met (even if there are omissions or deficiencies) it is very difficult for the trustee to prove that there has been improper management. This will only be the case where the Directors have acted irresponsibly or recklessly. In addition, the court may mitigate the damages to be paid and there is the same possibility of exculpation for individual Directors as under Section 2:9 DCC.

(c) Other company law

Joint and several liability of Directors towards third parties may also be based on:

- (i) transactions on behalf of a company which has never come into existence due to very serious defects in the incorporation (Section 2:4 DCC);
- (ii) transactions on behalf of a company entered into prior to its registration with the Trade Register and/or payment on shares (Section 2:180/69 DCC);
- (iii) transactions entered into on behalf of the company prior to its incorporation and not ratified thereafter (Section 2:203/93 DCC);
- (iv) infringement of provisions prohibiting the company and its subsidiaries from acquiring its own shares (Sections 2:207a/98a DCC) and
- (v) misleading presentation of the annual accounts, interim accounts and annual report (Section 2:249/139 DCC).

(d) Section 6:162 DCC – tort –

Directors are generally not liable towards creditors for debts of the company. However, they may be liable if they commit a tort in their capacity as Directors which would also be a tort if they acted for themselves. Based on court rulings it can be said that when a Director enters into a contract on behalf of the company and (i) at the time of the conclusion of the contract he knows or should reasonably know that the company will be unable to perform the obligations arising out of that contract within a reasonable period of time, and (ii) the company will not have assets for the creditor to take recourse against, under certain circumstances he commits a

tort against that creditor. A Director may also be personally liable on the basis of tort, if he is intensively involved with the company's business and has in fact (complete) control over the company's actions. Personal liability of a Director who at the same time (directly or indirectly) owns the entire share capital of the company may also exist on the basis of tort under certain circumstances, in the event the company does not perform its obligations towards a creditor as a result of its refusal to pay rather than as a result of its inability to pay.

4 Who can sue?

- 4.1** In the event Section 2:9 DCC has been breached only the company itself can make a claim. No shareholder or creditor may claim under Section 2:9 DCC. Moreover, class actions are not known under Dutch law. The company may also sue on the basis of Sections 2:95, 2:207a/98a, 2:207d/98d and 2:354 DCC (see paragraph 3.2.2. above).
- 4.2** As a general rule, a breach of contract or a commission of tort towards a company results in liability towards the company, but not to the shareholders. The damage suffered by the shareholders as a result of such breach of contract or tort is derived from and coincides with the damage suffered by the company. A shareholder only has a cause of action if the breach of contract or the tort of, for instance, a Director is tortuous towards the shareholder personally, i.e. where the Director intentionally causes damage to that shareholder.
- 4.3** The trustee in bankruptcy can claim compensation of the entire deficit upon liquidation from each Director on the basis of Section 2:248/138 DCC, if the Board of Directors has fulfilled its task “obviously improperly” and it is likely to be an important cause of the company's bankruptcy.
- 4.4** Creditors can only sue an individual Director or all Directors jointly and severally as indicated in paragraph 3.3.4. above.
- 4.5** Should (personal) liability of Directors exist for the various taxes and social security contributions mentioned in paragraph 3.3.1., the following authorities may sue such Director(s): (i) the Tax Collector (for taxes and national insurance premiums), (ii) the enterprise associations (for employees’ insurance premiums) and (iii) the enterprise pension funds (for pension contributions).

5 Can the company indemnify its Directors under Dutch law?

- 5.1** Under Dutch law a company may indemnify its Directors from both external and internal liability. However, it is questionable what the effect of such indemnifications in practice is.
- 5.2** A basis for the indemnification of a Director from external liability can be found in Section 6:170 DCC and Section 7:661 DCC respectively. Section 6:170 DCC provides – inter alia – that in the event both the employee and his employer are liable towards a third party for damage caused by tort of the employee, the employee does not contribute in the damages to be paid, unless the damage is a result of intent or willful recklessness on the part of the employee. It is likely that this Section applies directly to a Director who is employed by the company. It probably applies by analogy to a Director who is not an employee. Section 7:661 DCC provides that an employee who causes damage to his employer or to a third party to whom the employer is liable, is not liable to his employer, unless the damage is a result of intent or willful recklessness. Section 7:661 DCC applies directly to a Director who is employed by the company. It probably applies by analogy to a Director who is not an employee of the company.

Although an indemnification of Directors by the company seems useful in the event of a "normal" tort, Dutch legal authors seriously doubt whether in the event of intent, willful recklessness or gross or serious negligence such indemnification will be upheld in court. As a general rule, clauses which exclude liability caused by intentional acts or arising as a result of gross or serious negligence are in conflict with public policy and are therefore void. Insurance for Directors' liability is, in general, thought of as a more appropriate means to limit Directors' liability –with the exception of Directors' liability arising as a result of intent, willful recklessness or gross or serious negligence.

- 5.3** A basis for the indemnification of a Director from internal liability may be found in Section 2:9 DCC. Pursuant to Section 2:9 DCC and relevant case law a Director is only internally liable towards the company if he acts in a seriously negligent manner. In other words, there is no internal liability of a Director for ordinary negligence. It is questionable whether the indemnification of a Director from internal liability can be upheld in practice (see paragraph 5.2. above, second paragraph).
- 5.4** A Director may also be discharged of any internal liability in respect of his position as a Director of the company. Whereas an indemnification can be regarded as an acceptance of liability by the company towards the indemnified party on the basis of facts which

are not (yet) known, a discharge ("*décharge*") granted by the company means a release from actual or potential liability. Discharge is generally based on a resolution by the General Meeting of Shareholders. Except for Section 2:248/138 paragraph 6 DCC (the Third Abuse Act), the DCC does not deal with the subject of discharge. However, the articles of association of companies in the Netherlands usually provide that the adoption of the company's annual accounts constitutes a discharge of the Board of Directors for the management over the relevant financial year, to the extent that this management appears from the annual accounts and the General Meeting of Shareholders has not made a reservation with respect to the discharge. A discharge may also be granted in the form of a final release when a Director is dismissed by the General Meeting of Shareholders or resigns after a take-over or after a conflict. In the event of conflict of interests situations, the discharge may be granted by those who are authorized to represent the company, usually the Supervisory Board.

- 5.5** By granting a discharge, the company renounces any actual or potential claims against the Directors. However, a discharge does not affect the liability of the Directors towards third parties or their liability to the trustee in bankruptcy on the basis of the Third Abuse Act. A discharge granted on the basis of specific documents (such as the annual accounts) does not cover facts that do not appear from these documents. In addition, the principle of reasonableness and fairness may prevent reliance on a discharge under certain circumstances.

6 Is Directors' Insurance Legal?

- 6.1** Directors' insurance is legal under Dutch law. Therefore, the extent of protection provided to Directors by such insurance will be discussed below.
- 6.2** A so-called BCA-pool ("*Bestuurders-Commissarissen Aansprakelijkheids-verzekering*" or Directors-Supervisory Directors Liability Insurance) has been set up by 11 large insurance companies in the Netherlands. At this moment the BCA pool is market leader in the Netherlands with the BCA policy. Directors' liability insurance is also provided by AIG (Europe) Netherlands N.V. and a number of other large insurance companies that do not participate in the BCA-pool. Since most insurance policies related to Directors' liability do not deviate substantially from the BCA policy, this policy will be described in short below.
- 6.3** The policyholder is the company concerned and the company pays the insurance premiums. The insured persons are the former and future Directors (and Supervisory Directors) of the company. In

view of the collective responsibility of the Board of Directors, the members of such Board can usually only be insured collectively. The territorial applicability of the coverage, the size of the company, the number and quality of the insured parties, the financial situation of the company, the (number of) exclusions and the insured amount are factors that will determine the amount of premium to be paid. It should be noted that the amount of premium paid by the company is deductible for corporate income tax purposes.

- 6.4** The insured amount is the maximum amount to be paid by the insurance company per claim and per insurance year for the insured parties severally and collectively. Apart from compensation of damages to third parties, the insured amount includes compensation of costs made in connection with the defense of claims, which in turn includes litigation costs.
- 6.5** In general, the liability of present, future and past Directors is covered under the policy. Also, policy makers referred to in Section 2:248/138 paragraph 7 DCC and de facto Directors both referred to in Section 2:261/151 DCC are regarded as Directors within the meaning of the policy (conditions). The insurance covers both internal and external liability. Liability of one member of the Board of Directors towards another member is usually not covered.
- 6.6** Coverage is provided on a "claims made" basis. Thus coverage is provided for a liability arising out of mistakes made by one or more of the insured parties in their insured capacity which result in a claim for compensation of damages by a third party (i) during the term of the insurance policy or (ii) during a certain period prior to the inception date of the policy, provided that a claim against the insured party has been filed during the term of the policy and the insurance company has been notified in writing of such claim during the term of the policy or within 3 months after termination thereof. In the event the insurance company is notified by the insured parties of circumstances which could lead to a claim, but no claim is actually made until after the end of the term of the policy, this claim will also be covered.
- 6.7** The coverage provided under the policy may be limited due to (a large number of) exclusions. In accordance with the general rule of Dutch law, liability caused intentionally or arising as a result of willful recklessness or gross or serious negligence falls outside the scope of the insurance.
- 6.8** In the event of bankruptcy of the company, both the trustee and the Directors are entitled to buy extended coverage. During a period of 3 years starting from the date of bankruptcy claims made against an

insured party and filed within this period are covered, provided that they are based on acts committed during the term of the original policy. A predetermined additional premium must then be paid.

7 General Comments

- 7.1** In practice, Directors need not to worry about liability, provided they observe proper procedures and do not act recklessly or irresponsibly. Non-executive Directors will have to ascertain that the executive Directors meet these standards and to that end they will have to attend Board meetings regularly (at least several times per (financial) year, depending on the company's business) and read (at least quarterly) operational and financial reports from the executive Directors.
- 7.2** This memorandum is written with the sole intention to provide readers with a general overview of Directors' liability under Dutch law. The authors of this memorandum strongly suggest third parties with questions regarding the subject of Directors' liability under Dutch law to consult Dutch lawyers with expertise in this specific area of law.

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