

Chronicle directors' liability - improper performance of duties (part 1)

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1. Introduction

The management board is responsible for the day-to-day management of the company and determining its policy.

The manner in which the management board has performed its duties may result in the company and or one or more of its creditors suffering damages. In that case, the question arises whether a director can be personally liable to compensate for these damages.

In this chronicle, I will discuss judgments by Dutch courts on the personal liability of directors, rendered in the

period from January 2022 to May 2023.

In the first part of this chronicle, I will discuss judgments addressing the question of whether a director is personally liable for the company's damages due to improper performance of management duties. In the second part of this chronicle, I will discuss judgments addressing the question whether a director is personally liable in tort for the damages suffered by the creditors of the company. Finally, in the third part of this chronicle, I will discuss judgments addressing the question of whether a director is personally liable for the deficit in the company's bankruptcy estate due to manifestly improper management.

2. Improper performance of management duties

2.1. Introduction

A director is obliged towards the company to perform his management duties properly. If a director has failed to do so, the company may have suffered damages as a result. A director is personally liable for these damages if he can be seriously blamed for his acts or omissions.



When assessing whether a director is seriously to blame, all the circumstances of the case must be taken into account. Among the circumstances to be taken into account are the nature of the activities performed by the company, the risks generally arising therefrom, the division of duties within the management board, any directives applicable to the management board, the information the director had or should have had at the time of the decisions or conduct complained of, and also the insight and care that may be expected of a director who is qualified for his management duties and performs them meticulously.

2.2. International jurisdiction

A Dutch court has international jurisdiction over a legal action for improper performance of management duties against a director if the director in question is domiciled in the Netherlands. If the director in question is not domiciled in the Netherlands, a Dutch court still has international jurisdiction over this legal action if the director in question provided or should have provided his management duties in the Netherlands pursuant to the agreement between him and the company. This

“agreement” can also be derived from the articles of association or any other document specifying the management obligations of the director.

In a judgment dated 9 September 2022, the Amsterdam District Court ruled that a director residing in Paris had provided, or at least should have provided, his management duties in Amsterdam pursuant to an agreement with the company. The court came to this judgment because the shareholders had deliberately chosen to establish the company in Amsterdam and to apply for a licence from the Dutch Authority for the Financial Markets in order to be able to offer a platform to invest in securities to consumers. Furthermore, the articles of association of the company state that the general meeting of the company must take place in Amsterdam. According to the court, this is then the place where the board must account for its policy to the shareholders of the company. Finally, the company’s board regulations stated that the management board has to meet in Amsterdam. For this reason, the court ruled that it has international jurisdiction over the legal action

for improper performance of management duties initiated by the company against the director who resided in Paris.

2.3. Limitation period

A legal action for damages based on improper performance of management duties is time-barred by the expiry of a five-year period. The limitation period begins to run on the day following the day on which the company became aware of its damages and the director liable for it. This requirement implies that the company is actually able to bring the legal action for compensation of its damages. This will be the case if the company has obtained sufficient certainty – which need not be absolute certainty – that the damages were caused by the improper performance of management duties by one or more of its directors.

In proceedings in which the Overijssel District Court ruled on 16 February 2022, the bankruptcy trustee accused the former directors of having transferred valuable parts of the bankrupt company to other legal entities of which they were directors and shareholders, while the bankrupt

company continued to bear the costs associated with those parts. According to the bankruptcy trustee, the former directors had, by their actions, improperly performed their management duties. For this reason, he claimed from the former directors payment of the damages suffered by the bankrupt company. According to the former directors, this legal claim was time-barred.

The court states that the basic principle is that the knowledge of a director is attributed to the company. This means that the moment the management board becomes aware of acts of the former directors that result in damages to the company and create a liability towards the company, is therefore also the moment at which the company can bring a legal action and claim and the payment of damages. This is then also the moment as of which the limitation period starts to run.

In a judgment dated 11 September 2020, the Dutch Supreme Court accepted an exception to the basic principle that the knowledge of a director is attributed to the company. In that case some former directors had

deliberately concealed from their fellow directors that they had a financial interest in a company to which an insurance portfolio had been transferred, thereby creating an improper conflict of interests. According to the Dutch Supreme Court, as a result of this concealment the limitation period for the legal action for improper performance of management duties against the former directors had not started to run until the day the fellow directors became aware of the former directors' improper conflict of interest.

According to the court, the present case is not similar. The alleged conduct by the former directors took place in the open, or at least known to all the other directors. Nor has the bankruptcy trustee, according to the court, alleged that the former directors had an improper conflict of interests. In view of this, according to the court, the bankruptcy trustee has not sufficiently substantiated that an exception should be made to the basic principle that knowledge of the directors should be attributed to the company.

The following observation can be made on this judgement. Although part of the alleged conduct had occurred when the company also had two other directors, these two other directors were not authorised to represent the company and could thus not initiate a legal action against the former directors. The other part of the alleged conduct had taken place when only the accused former directors were in office. Therefore, it was not obvious that the former directors would bring a legal action for the improper performance of management duties on behalf of the company against themselves. However, according to the court, this is irrelevant because this is not a ground for exception mentioned by the Dutch Supreme Court in its ruling of 11 September 2020. For that situation, the law provides that the limitation period is extended with six months after the relevant director's resignation. According to the Dutch Supreme Court, it follows from this statutory provision that the general limitation rules – i.e. also with regard to the starting point of the limitation period – also apply in the case where the company wants to sue its director for improper performance of management duties.

“The basic principle is that the knowledge of a director is attributable to the company.”

In view of the fact that alleged actions by the former directors had taken place more than five years before the issuance of letters of interruption of the limitation period by the bankruptcy trustee, the court ruled that the legal action for damages based on improper performance of management duties against the former directors is time-barred.

2.4. Conflict of interest

In discharging his management duties, a director must be guided by the company's interests. Therefore, a director may not participate in the decision-making process of the management board if he has a direct or indirect personal interest that conflicts with the interest of the company. If a director has such an interest, he must disclose this to his fellow directors. Subsequently, the director concerned must refrain from taking decisions on the subject in which he has a conflict of interests. If it concerns a decision for which the supervisory board has a right of approval, the supervisory board must be informed about the conflict of interests and the way in which the decision-making took place. If all directors have a conflict of interests, the

decision is taken by the supervisory board. And if the supervisory board is also conflicted or absent, the decision is taken by the general meeting, unless the articles of association of the company provide otherwise. In proceedings in which the Arnhem-Leeuwarden Court of Appeal ruled on 14 February 2023, a former director had entered into financial transactions on behalf of two companies with other companies in which he had a financial interest. These financial transactions involved an amount of approximately EUR 31 million. That money was intended for the construction of a power plant and a power generation project. Both projects had failed, wiping out the two companies' entire investment. The two companies blamed their former director for concealing his financial interest in these other companies and claimed compensation for the damages they had suffered.

The former director's defence was that he had not been out for his own gain. He alleged that the two projects were initiated in the interest of city of Steenwijk's citizens and businesses. The court ruled that this did not excuse

the former director, as he knew that the investment was unfavourable in an economic sense and involved many risks. This should have made the former director realise that he should have informed the two companies that the interests he allegedly served with his advice and decisions were different from the interests of the two companies. According to the court, the term "own interest" refers to any interest intended to be served by a director that does not run parallel with the interests of the company. So if a director had any good intentions, these do not excuse him if he had a conflict of interests.

Subsequently the court ruled that the former director had a conflict of interests based on, among other things, the fact that (a) the financial transactions involved a large amount of money, (b) the investment made by the two companies was unfavourable in economic terms and involved many risks, and (c) the former director had a financial interest in the companies with which the financial transactions had been entered into. According to the court, the effect of this combination of facts amounted to a conflict of interests that the legislator precisely

intended to prevent, as this conflict limited the freedom of the former director to take decisions with regard to the financial transactions that were exclusively in the interests of the two companies.

Next, the court ruled that the former director had improperly performed his management duties, because he had failed to inform the supervisory board members and shareholders of his conflict of interests in the financial transactions and had nevertheless participated in the decision-making on these transactions. By doing so, the director acted contrary to the essence of his management duties, namely that he had to keep only the interests of the two companies in mind. The court finds that the former director is liable for the damages suffered by the two companies, because the two companies had proven that it would not have entered into the financial transactions if they had been aware of the conflict of interests.

2.5. Infringement of competition law

In proceedings in which the Court of Appeal of Arnhem-

Leeuwarden ruled on 6 December 2022, a bankruptcy trustees alleged that the actions of a former director resulted in the imposition of cartel fines on the company and claimed these cartel fines as damages from the former director based on improper performance of management duties.

The former director argued as a defence that the cartel fines should not be allowed to be claimed from him as damages, because otherwise the company would be de facto unjustly enriched by being able, on the one hand, to profit from a prohibited price cartel for years and, on the other hand, be allowed to recover the "net damages" from its director if that cartel were to be discovered. The court gave short shrift to this defence. The obligation of proper performance of management duties aims to protect the company from the harmful consequences of seriously culpable actions of its directors. Making price agreements threatened with sanctions obviously falls under this. A director who knowingly violates the law and thereby causes damages to the company, acts seriously culpable and is in principle obliged to compensate the company's

damages. The positive consequences of the price agreements for the company should only be taken into account when assessing the amount of the damages the former director is liable for.

The former director further argued on the basis of a ruling by the Landsgericht Saarbrücken that passing on the cartel fines to him would go against the purpose and useful effect of the European cartel ban. The company should pay the cartel fines itself and not be able to pass them on to others.

According to the court, the case of the Landsgericht is not comparable. That case involved a company that would continue to exist after recovering the cartel fines from others. The present case involves a bankrupt company that cannot pay the cartel fines and will cease to exist after the finalisation of the bankruptcy. Therefore, the bankrupt company itself has no interest in the bankruptcy trustees' legal action. That legal action was brought for the benefit of the joint creditors who were not involved in the prohibited cartel agreements and at the expense of

the director who was. According to the court, this is not contrary to the purpose and useful effect of the European cartel ban.

On the question of whether the former director performed his management duties improperly, the court found that there had been a long-term direct and personal involvement by the former director in conduct by the company to restrict competition. That conduct violated competition law, of which the former director could be deemed to have been aware. A director acting reasonably can be expected to have informed himself in advance of the nature and scope of the activities of the company or companies to be managed. In addition, a director acting reasonably can be expected to pay particular attention to compliance with the rules applicable in that respect, or at least to have himself informed about it by experts. Nevertheless, the former director allowed the company to engage in activities contrary to competition law. Therefore, according to the court, the former director not only caused or allowed the company to breach its legal obligations, but also knew or

at least should have understood that the company's conduct, which he caused or allowed, would result in the company breaching its legal obligations. In addition, according to the court, the former director knew or at least should have understood that this conduct, the violation of competition law, could lead to prejudice to (the creditors of) the company, for example through (very high) public law fines and (very large) financial penalties being levied on the company. In view of this, the court ruled that the former director has improperly performed his management duties and is, in principle, obliged to compensate the company for the damages suffered as a result thereof.

Finally, the former director argued that the bankruptcy trustee should not be allowed to claim the imposed cartel fines as damages, because these had not paid. The court dismissed this defence. The starting point is that the company suffered damages because the cartel fines were added to its estate as a debt. Leaving these fines unpaid or declaring the company bankrupt does not alter this. According to the court, this also applies if at any time

it would be established that the cartel fines (even after they have been recovered as damages) could no longer or not fully be paid from the bankruptcy estate. The fact that it cannot be assumed that the bankruptcy was caused by the alleged conduct by the former director does not preclude the causal link described above. After all, according to the court, this assessment concerns the question whether the company itself was harmed by the alleged conduct, and not whether the joint creditors suffered damages as a result of that conduct.

3. In conclusion

In the first part of this chronicle, I discussed rulings on the personal liability of directors for improper performance of duties. This covered the international jurisdiction of a Dutch court, the limitation period of legal claims for improper performance of duties, entering into financial transactions in which the director has a conflict of interest, and the personal liability of a director for cartel fines imposed on the company.

Should you have any questions about directors' liability, please contact René van de Klift.

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