Chronicle directors' liability - tort (part 2)

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1. Introduction

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

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 have discussed judgments addressing the question of whether a director is personally liable for the company's damages due to improper performance of management duties. In this second part of this chronicle, I will discuss judgments addressing the question of whether a director is personally liable in tort for the damages of 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. Unlawful act

2.1. Introduction

If a company fails to perform an obligation or commits a wrongful act, the basic principle is that only the company is liable for the resulting damages. However, under special circumstances, in addition to liability of the company, there is also room for liability of a director of the company. The assumption of such liability requires

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that the director is personally and seriously culpable.

Thus, the requirements for assuming the liability of a director in addition to the company are higher than in general. A high threshold for liability of a director towards a third party is justified by the circumstance that, vis-à-vis the other party, the acts of the company are primarily involved and by the public interest in preventing directors from allowing defensive considerations to determine their actions on behalf of the company to an undesirable extent. The answer as to whether a director is personally and seriously culpable depends on the nature and seriousness of the norm violation and the other circumstances of the case.

If a director has entered into an obligation on behalf of the company, he is personally and seriously culpable if he knew or should reasonably have understood when he entered into the obligation that the company would not be able to fulfil its obligations and would also not offer any recourse, except for circumstances to be adduced by the director on the basis of which the conclusion is justified

that he cannot be personally blamed for the wrongdoing. If a director has caused or permitted the company to breach its statutory or contractual obligations, he can be personally blamed if he knew or should reasonably have understood the company's conduct, which he caused or permitted, would result in the company failing to fulfil its obligations and also failing to provide a remedy for the damage occurring as a result.

Other circumstances may also arise on the basis of which a serious blame towards a director may be assumed.

2.2. International jurisdiction Peeters/Gatzen claim

A bankruptcy trustee is also authorised in certain circumstances to act on behalf of the interests of joint creditors on the grounds of tort. The legal action can be brought against a third party, such as a director, who was involved in acts that were detrimental to the interests of the joint creditors, even though this legal action did not accrue to the bankrupt company itself. This is called a Peeters/Gatzen claim.

On 6 February 2019, the European Court of Justice ruled that a Peeters/Gatzen claim falls within the scope of the recast EEX Regulation. This means that, in principle, a Dutch court does not have international jurisdiction to hear a Peeters/Gatzen claim against a defendant domiciled in another Member State of the European Union. This is only different if the harmful event occurred in the Netherlands. In that case, the Dutch court does have international jurisdiction.

In proceedings in which the Central Netherlands District Court rendered a final judgment on 13 July 2022, a bankruptcy trustee accused a German grandmother company of having breached a duty of care towards the joint creditors of its Dutch granddaughter company by financing the losses of this granddaughter company for several years and subsequently terminating the financing abruptly. Shortly thereafter, this granddaughter company was declared bankrupt leaving the joint creditors with unrecoverable claims. To determine its international jurisdiction, the court had to determine whether the damaging event had occurred in the Netherlands. The

court was unable to determine this and therefore sought clarification from the European Court of Justice.

On 10 March 2022, the European Court of Justice ruled that for creditors' claims because a grandparent company has breached a duty of care towards them, the place of establishment of the bankrupt company, which as a result no longer provides recourse to these creditors, is also the place where the harmful event occurred. According to the European Court of Justice, it may be assumed that at the place of establishment of the bankrupt company information is available on the development of the company's financial situation (read: the erosion of the company's assets as a result of the loss-making operation of its business), on the basis of which it is possible to assess whether the duty of care – as claimed – has been breached by the grandparent company, and if so, to what extent.

It then comes as no surprise that the Central Netherlands District Court subsequently ruled that it has international jurisdiction to hear the Peeters/Gatzen claim against the German grandmother company. After all, the bankrupt granddaughter company was domiciled in the Netherlands.

Unfortunately, this does not mean that the Dutch courts always have international jurisdiction to hear a Peeters/Gatzen claim by a bankruptcy trustee of a Dutch company. In the case that gave rise to the European Court of Justice ruling of 13 July 2022, a receiver of a bankrupt Dutch company had accused a Belgian bank of having cooperated with the director's withdrawal of a large amount in cash from a bank account at a branch in Belgium. After the ruling by the European Court of Justice, the Dutch Supreme Court ruled that the damaging event in that case had occurred in Belgium. According to the Dutch Supreme Court this was not only the place where the director had withdrawn the money in cash, but also the place where the joint creditors had suffered damages because it was the place where the company’s positive balance had disappeared from its bank account.

This means that a Dutch Court for each Peeters/Gatzen claim must separately determine where the damaging event occurred in order to determine its international jurisdiction if the defendant is domiciled in another member state of the European Union.

2.3. Erosion of security interests

In a case ruled upon by the Arnhem-Leeuwarden Court of Appeal on 28 February 2023, the director of a debtor of a pledged claim had withdrawn that debtor's assets from the pledgee's recovery. The pledgee then sued the director for damages based on tort for recovery frustration. The director then took the position that the pledgee did not have the right to bring this legal action against him. According to the director, this right still belonged to the pledgor. The court dismissed this defence, because the pledgee had already disclosed its pledge on the claim. As a result, the authority to collect the claim had passed to the pledgee. That authority includes the right to seek recourse on the debtor's assets. If the director then frustrates the exercise of that right by withdrawing the debtor's assets from that recovery, the director can be seriously blamed if he could foresee that

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the pledgee would be prejudiced as a result thereof. According to the court, the director could foresee this and therefore the director is personally liable for the pledgee's damages.

In proceedings in which the Arnhem-Leeuwarden Court of Appeal ruled on 21 March 2023, a shareholder had transferred its shares in a company to a foundation to prevent recourse by a third party on those shares. The foundation had owed the purchase price and had created a pledge on the shares as security for the payment of the purchase price. One of the co-shareholders in the company became the director of the foundation. This director had voted in favour of resolutions at the company's general meeting to convert loans granted by two shareholders into share capital and sharply write-down the nominal value of the shares. This had significantly diluted the foundation's equity interest in the company. The shareholder also pledgee accused the director of the foundation of acting unlawfully towards him by cooperating with the conversion and the write-down.

The court ruled that merely cooperating with the conversion and the write-down is not unlawful. Therefore additional circumstances are required. According to the court, these were present because there was no objective necessity for the conversion and write-down. As a result of these actions, no additional capital had been provided to the company, nor had it become apparent that the bank had made this a condition precedent for continuing financing to the company. The foreseeable consequence of the conversion and the write-down is the substantial dilution of the foundation’s equity interest in the company, even though the director was aware of the intentions of the chosen "sham construction" and the interest of the shareholder also pledgee in that construction. In that situation, according to the court, it is socially unbecoming not to inform the shareholder also pledgee about the conversion and write-down. This prevented the shareholder also pledgee either to oppose these actions or to have the foundation purchase additional new shares to avoid the substantial dilution of its equity interest in the company.

In light of the above, the court ruled that the director acted unlawfully towards the shareholder also pledgee. According to the court, the director knew or should have known that the foundation's conduct, which the director brought about or allowed, would result in the foundation not fulfilling its obligations towards the shareholder also pledgee and also not providing recourse for the shareholder also pledgee' damages. The director is therefore liable for these damages, according to the court.

2.4. Restructuring

In a case in which the Rotterdam District Court ruled on 6 July 2022, a Dutch company had co-bonded for the obligations of its Belgian sister company. When the latter was unable to fulfil its obligations, the creditor commenced proceedings in Belgium against both companies. In first instance, the claim was rejected, after which it was awarded on appeal.

Shortly after the dismissal of the claim in first instance, a restructuring of the group to which the Dutch company belongs was commenced. As a result of this restructuring, all activities of the Dutch company were transferred to a new branch of the group. Furthermore, all intercompany claims of the Dutch company against group companies were settled by offsetting, inter alia, the purchase price due for the transferred assets. The restructuring was eventually completed a few months after the claim was awarded in appeal. Not long thereafter, the Dutch company was declared bankrupt. The bankruptcy trustee sued the director of the Dutch company to pay damages based on tort for prejudice of the joint creditors of the Dutch company by commencing and completing the restructuring, as a result of which there were no assets left in the estate for recourse for the joint creditors.

According to the court, the creditor's claim and the attachments made as security for it were the reason for the restructuring. It was then decided by the director to transfer the business to a new branch of the group. This amounted to a de facto liquidation of the Dutch company. And although the creditor's claim had been dismissed in

first instance, according to the court, this did not mean that the director no longer had to take that claim into account. The director could and must have been aware that in appeal the decision on the liability of the Dutch company could be different. This was all the more true when the creditor had actually filed an appeal and the appeal proceedings unfolded. According to the court, the arguments put forward in the appeal proceedings to the disadvantage of the Dutch company should have been an indication to the director that the proceedings could also be decided against the Dutch company. Nevertheless the director proceeded with the liquidation of the Dutch company. This while he must and could have been aware that the award of the creditor's claim in appeal would de facto mean the bankruptcy of the Dutch company.

In view of the above, the court ruled that the director can be held personally and seriously culpable, as he knew or reasonably should have understood at the time of the restructuring that the interests of the joint creditors would be prejudiced by the restructuring. Therefore, the court ordered the director to compensate the damages suffered by the joint creditors.

The question is how this ruling relates to a Dutch Supreme Court ruling of 4 April 2014. In that case, the Dutch Supreme Court ruled that for a serious blame to exist, it is sufficient that a director, at the time of the implementation of a restructuring pending proceedings, *should have seriously taken into account the possibility* that, despite an alleged counterclaim, a claim against the company would remain as the outcome of those proceedings, which could no longer be satisfied as a result of the restructuring. This standard appears to be more stringent that the standard applied by the court that the arguments raised in the proceedings *should have been an indication* for the director that the appeal proceedings could also be decided against the Dutch company.

3. In conclusion

In the second part of this chronicle, I discussed rulings on personal liability of directors on the grounds of tort. This covered the international jurisdiction of a Dutch court to hear Peeters/Gatzen claims and the personal liability of directors for erosion of security rights and carrying out a restructuring.

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