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LIABILITY OF COMPANY DIRECTORS: THE BUSINESS JUDGMENT RULE AS DEVELOPED IN THE US AND ADOPTED BY GERMANY COMPARED TO THE NETHERLANDS' APPROACH

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ABSTRACT

This paper compares the business judgment rule as developed in the US (specifically the state of Delaware) and adapted by Germany, with the Netherlands' regime for directors' liability. In the Netherlands, judicial review of directors is considered marginal, because courts will only intervene where it is sufficiently clear by objective measures that a director has used their administrative freedom in such a way that it does not deserve to be respected. The burden of proof, which is considered to be high, rests on the plaintiff, pursuant to general procedural law. Regarding the US business judgment rule, the threshold of proof is lower. The rule is both a 'shield' for directors (since plaintiffs must initially rebut a presumption in the director's favor) and a 'sword' for plaintiffs (since the burden of proof then moves to the director, who must show the decision made was fair). This paper proposes that the Netherlands make an exception to the general rule that the burden of proof rests upon the plaintiff suing a large company, considering the special responsibility that larger companies, particularly in the finance sector, should have towards society as a whole. This is supported by an analysis of Dutch directors' internal liability cases, which shows that, had the Delaware business judgment rule been applied, it is the threshold of proof factor that would have prompted a different outcome.

I. Introduction

In the media there is often news of mismanagement, bank crashes, corporate bankruptcies and government bailouts that are giving rise to more and more shareholders or stakeholders looking to hold directors liable for mismanagement. In particular, after the global financial crisis government bailouts, there was demand for reflection on the functioning of risk-management and corporate governance in financial institutions and large corporations, because it was apparent that directors had, "failed to prudently govern and oversee the management and business affairs of their companies when they approved too risky strategies."[1] Directors and supervisory directors, who have made gross mistakes, also give themselves large bonusses or severance payments, while the

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[1] Ashby, S., 'The Turner Review on the Global Banking Crisis: A Response from the Financial Services Research Forum, The University of Nottingham 2009', p.7 <https://www.nottingham.ac.uk/business/businesscentres/gcbfi/documents/researchreports/paper61.pdf>.

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company, shareholders and stakeholders are left to carry the losses.[2]This seems unfair, and in this thesis the action of holding directors liable by shareholders or stakeholders will be delineated.

In large companies, the power is delegated to central management, being the board of directors. '[T]he result is that power passes from its residual owners (the shareholders) to persons who act on mandate from the shareholders to perform certain duties (the management)'.[3]

Management or the board of directors are explicitly given the power to act on behalf of the company by the corporate law statutes, however there are restrictions, which regard conflict of interest of directors.[4] In making decisions "to determine the course of the company's business operations", the board must satisfy duties of care, loyalty and good faith.[5] These are generally referred to as the fiduciary duties.

The regime for liability of directors, executive and non-executive, in companies, establishes a mandatory consequence to control issues within a company. This is founded on the attribution of specific duties; it constitutes the boundaries of the directors' behavior and it provides legislative protection for stakeholders and other parties doing business with the company against directors' misconduct. In that regard, 'directors' liability is an important and effective compliance and risk-allocation mechanism.[6]

In the US, it was understood centuries ago that directors needed freedom to do business. In 1829, the Supreme Court of Louisiana held that a director cannot be held responsible for a course of action which had resulted in loss when this course of action was done prudently.[7] This was the precursor to the introduction of the business judgment rule, as a special standard that can be applied when a management decision is brought to be reviewed by the court. Nonetheless there are certain requirements for the business judgment rule to be applicable. The effect of the business judgment rule is to protect directors from civil liability in their decision-making: there is a presumption to the benefit of the directors, because they must have freedom to carry out their duties without retribution from unsatisfied shareholders and stakeholders.[8] What is then the effect of

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2 Eshuis, R.J.J., Holvast, N.L., Bunt, H.G. van de, Erp, J.G. van, and Pham, N.T., *Het aansprakelijk stellen van bestuurders, Onderzoek naar overwegingen die spelen bij het al dan niet intern aansprakelijk stellen van bestuurders en interne toezichthouders*, Boom Lemma Uitgevers 2012.
European Commission, Study on Directors' Duties and Liability, Department of Law, London School of Economics 2013, p. 925,
<https://www.guberna.be/sites/default/files/trainings/Reader/NL_reader_2014/study%20director%20duties_liabilities%20in%20Europe%20427%20pages%20Apr13.pdf>.
3 Ibid.
4 Deipenbrock, G., *The 'Business Judgment Rule' and the Problem of Hindsight Bias – Observations from a German Company Law Perspective*, European Business Law Review, Kluwer Law International 2016. p. 200.
5 Cahn, A. and Donald, D.C., *Comparative Company Law*, Cambridge 2010, pg. 369.
6 European Commission, Study on Directors' Duties and Liability, pg. vii.
7 *Percy v. Millaudon*, 8 mart. 68 (La.1829).
8 Smith, D.G., The Modern Business Judgment Rule, SSRN 2015, p.130
<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2620536 >.

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the business judgment rule for the shareholders and stakeholders when they bring a liability claim before the court?

Within Europe, Germany was the first to adopt the business judgment rule in 2005 and subsequently codified it in their company law, primarily in the Stock Corporation Act (*Aktiengesetz or AktG*) under § 93(1). While the business judgment rule is supposed to protect directors from the possibility of personal liability for making risky decisions in doing business, contrary to the US, the German business judgment rule does not initiate a presumption to the benefit of the directors. First the directors need to show that there is no conflict of interest and that the decision was taken on a reasonable informed basis.[9]

In the Netherlands, no business judgment rule is present. Pursuant to the Dutch Civil Code (*het Burgerlijk Wetboek or BW*) each director is bound to a proper fulfillment of their assigned duties. The director will be fully liable for any subsequent shortcomings, unless there is no negligence in taking the needed measures to prevent such shortcomings.[10] The Dutch Supreme Court held that when a claim is brought against a director the court reviews the proper fulfillment of their assigned duties on the basis of the 'serious reproach' standard.[11]

This research will focus on the differences and commonalities of the business judgment rule between the US, specifically the State of Delaware, and Germany, with the Netherlands claims regarding directors' internal liability, for risky decisions with a negative outcome.

<u>Research Question</u>

In this thesis the following question will be researched:

What would the difference in outcome be regarding Dutch directors' internal liability cases from 2010 to 2018, if the Delaware business judgment rule would have been applied? More specifically, how important is the duty of loyalty for directors' liability in Dutch case law compared to the US business judgment rule?

Sub-questions:

- How does the business judgment rule relate to breaches of fiduciary duties? Specifically, the duty of loyalty.
- How is the Netherlands company directors' internal liability regulated? And does it encompass the duty of loyalty?
- What is the threshold of proof required for the business judgment rule compared to the Dutch (internal) liability cases?
- Should the Netherlands adapt the German version or the US version of the business judgment rule?

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[9] Deipenbrock, G., *The 'Business Judgment Rule' and the Problem of Hindsight Bias – Observations from a German Company Law Perspective*, European Business Law Review, Kluwer Law International 2016.p. 209.

[10] Dutch Civil Code, article 9 of book 2.

[11] *Staleman v Van de Ven*, HR 10 january 1997, NJ 1997, 360.

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The sub-questions will lead to the answer of the main research question by analyzing and comparing the common law of Delaware with the civil law of the Netherlands regarding directors' internal liability and protection.

Chapter I provides an introduction to the subject matter, followed by Chapter II regarding the history of the business judgment rule in the US as well as the definition, required elements and whether it is used as a 'shield or sword'. Chapter III gives an overview of the German business judgment rule. In Chapter IV and V the Dutch directors' internal liability is discussed with views from scholars *pro and contra* the introduction of a Dutch business judgment rule, empirical data as well as an analysis of Dutch internal liability cases from 2010 to 2018 in order to answer the research question. This is followed by an overview comparison in Chapter VI and the subsequent conclusion in Chapter VII

Originality

The proposed research is original as the element of duty of loyalty set against the business judgment rule and Dutch director's internal liability has not been done before. The business judgment rule was developed in a common law country and was thought initially to not be necessary for civil law countries. Within the European Union (EU) some countries have now adopted the business judgment rule. Germany, being a civil law country, adopted the business judgment rule in their company law, and have generated jurisprudence over the years, which, against the background of shareholders and stakeholders seeking more protection, leads to the question whether the Netherlands should follow their lead or not. In that regard there must first be researched whether there would be a difference in the outcome of cases in the Netherlands if the business judgment rule would have been applied. Such research has not been undertaken as of yet, hence this thesis.

II. Business Judgment Rule

The business judgment rule is not a rule but rather a standard,[12] which has been developed in case law.[13]

The business judgment rule is basically a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.

II.1. The Business Judgment Rule: Shield or Sword?

The business judgment rule is a procedural guide regarding the burden of proof to a specific relationship, i.e. between shareholder(s) and director(s). According to Manning

[12] See page 11.

[13] Ponta, M. and Catana, R.N., The Businsses Judgment rule and its reception in European Countries, The Macrotheme Review 2015, p.128 <http://macrotheme.com/yahoo_site_admin/assets/docs/12MR47Po.34735941.pdf>

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the business judgment rule could be used as a shield or a sword.[14] The business judgment rule starts as a shield or safe harbor for the decision/action(s) taken by the director(s) by placing the burden of proof on the plaintiff.

The shield is the presumption that the directors "acted on an informed basis, in good faith … that the action taken was in the best interest of the company [and its shareholders]."[15] However the burden of proof is just to allege facts sufficient to overcome that initial presumption,[16] i.e the rebuttal of the applicability of the business judgment rule presumption.

Once the shareholders have successfully rebutted the presumption, the business judgment rule becomes a sword for the plaintiff, because now the burden of proof moves from the plaintiff to the directors; i.e. that the "defendants [have] to prove to the trier of fact that the challenged" decision was fair in its entirety.[17]

The business judgment rule does not qualify as a rule, but rather as a standard. This is because the business judgment rule was given many formulations over time since its introduction in Percy v. Millaudon[18] in 1829, where the Supreme Court of Louisiana held that:

> "the adoption of a course from which loss ensues cannot make the [director] responsible, if the error was one into which a prudent man might have fallen."

This means that directors needed freedom to do business, and thus the Supreme Court of Louisiana held that a director cannot be held responsible for a course of action which has resulted in loss when this course of action was done prudently.

In Delaware the current formulation of the business judgment rule in the Delaware General Corporation Law under article 141 DGCL[19] was first used in 1984 in the Aronson v. Lewis[20]:

> "[The business judgment rule] is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption."

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[14] Manning, B., *The Business Judgment Rule in Overview*, Ohio State Law Journal 1984, Ohio State University, p. 616.
[15] *Emerald Partners v. Berlin* (Del.Supr. 2001); Aronson v. Lewis (Del. Supr. 1984).
[16] *Reget v. Paige* (2001 WI App 73).
[17] Welch, E.P., Saunders, R.S, Land, A.L., Voss, J.C., Turezyn, A.J., *Folk on the Delaware General Corporation Law: Fundamentals*, Wolters Kluwer Law & Business 2015, pg. 164; *Emerald Partners v. Berlin* (Del. Supr. 2001); *Cinerama, Inc. v. Technicolor*, Inc. (Del. Supr. 1993).
[18] *Percy v. Millaudon*, 8 Mart. 68 (La.1829).
[19] Article 141 Delaware General Corporation Law (DGCL).
[20] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

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The business judgment rule insulates the board's decision from judicial review when the following conditions are fulfilled:

> '(1) the director actually made a business decision;
> (2) the directors inquired into, were reasonably informed about, and deliberated on their decision (careful);
> (3) the directors were disinterested with regard to the decision (loyal); and
> (4) in making the decision, the directors were unbiased and motivated by the welfare of the corporation (acting in good faith).'[21]

The latter three presumptions are regarded as the fundamental fiduciary duties of directors: the duty of care and the duty of loyalty; the duty to act in good faith is classified under the duty of loyalty. Directors must fulfill these duties in the execution of their work.

II.2.1. Duty of Care

Duty of care is the primary director's duty in execution of their tasks. A prerequisite for the duty of care is that directors are 'reasonably informed about', and have consulted and considered 'all material information reasonably available to them' before making their corporate decision.[22] Thus, the director is not required to be aware of all the facts and even in case of an evident mistake in judgment the director will be disculpated from personal liability in litigation. The condition in this case is the 'quality of the information, the advice considered by the board, and whether the board had sufficient opportunity to acquire knowledge concerning the problem before acting'.[23]

The Delaware judges uses the 'gross negligence' standard to test whether the board had fulfilled the duty of care in their decision making.[24] This test was done in Smith v. Van Gorkom[25] (Van Gorkom) where the court held that the board of directors did not fulfill their fiduciary duty of care to the shareholders:

> firstly 'by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the merger and [secondly] by their failure to disclose all material information such as a reasonable stockholder would consider important' before condoning the decision thus resulting in gross negligence.[26]

[21] Smith, D.G., The Modern Business Judgment Rule, SSRN 2015, .p. 3, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2620536 >

[22] Lafferty, W.M., Schmidt, L.A. and Wolfe, D.J., A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law, Penn State Law Review 2012, p. 842 http://www.pennstatelawreview.org/116/3/116%20Penn%20St.%20L.%20Rev.%20837.pdf.

[23] Ibid., p. 843.

[24] Sharfman, B.S., The Enduring Legacy of Smith v. Van Gorkom, The Delaware Journal of Corporate Law 2014, p.289,< http://www.djcl.org/wp-content/uploads/2014/08/The-ENDURING-LEGACY-OF-SMITH-V.-VAN-GORKOM.pdf>.

[25] *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

[26] Sharfman, B.S., The Enduring Legacy of Smith v. Van Gorkom, The Delaware Journal of Corporate Law 2014, p.292, < http://www.djcl.org/wp-content/uploads/2014/08/The-ENDURING-LEGACY-OF-SMITH-V.-VAN-GORKOM.pdf>.

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The assessment of the duty of care 'is not whether the content of the board decision leads to a loss, but more the consideration of good faith or rationality of process of decision making'.[27] Basically the board of directors should not be clumsy in the collection of information.[28] Pursuant to Graham v. Allis-Chalmers[29] "directors are entitled to rely on the honesty and integrity of their subordinates until something occurs to put them on suspicion that something is wrong". However, it is the responsibility of the directors that the 'corporation's information and reporting system is, in concept and design, adequate to assure the board that appropriate information will come to its attention in a timely manner as matter of ordinary operations.'[30]

II.2.2. Duty of Loyalty

The duty of loyalty requires that the director has no personal interest above the interest of the corporation and its shareholders.

> Pursuant to Guth v. Loft[31] the duty of loyalty means that the directors are prohibited from (i) having the corporation venture in an:
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> "interested transaction which is not entirely fair to the corporation; (ii) profit from the use of confidential corporate information; (iii) take any action solely or primarily to entrench themselves in office; or (iv) otherwise place benefits to themselves or to affiliated entities ahead of benefits of the corporation."[32]

In the event that there is any interest of a director regarding the decision then this must be disclosed timely to the whole board so the appropriate actions can be taken to quarantine any conflict of interest from the process leading to the decision. One can think of excluding the interested director from negotiations and bringing in 'independent advisors to assist the board in considering potentially conflicting transactions.'[33]

If the board of directors is not successful in insulating the decision-making process from the interested director, then in all likelihood they cannot invoke the business judgment rule. Meaning that in case of a challenged decision there would be no presumption to protect them and thus they would have to prove that the action was fully fair towards the corporation and its shareholders.[34]

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[27] Calkoen, W.J.L., Fiduciary duty violations under corporate law, business judgment rule, duty of loyalty, duty of care, Kluwer 2012, p. 4, <https://www.navigator.nl/document/id0b984e6ef261e998f97a8af16360a341?ctx=WKNL_CSL_1474>.
[28] Ibid.
[29] *Graham v. Allis-Chalmers*, 188 A.2d 125 (Del. 1963).
[30] Caremark International Inc. Derivative Litigation, 698 A. 2d 959 (Del. Ch. 1996).
[31] *Guth v. Loft*, 5 A.2d 503 (Del. 1939).
[32] Lafferty, W.M., Schmidt, L.A. and Wolfe, D.J., A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law, Penn State Law Review 2012, p. 845, <http://www.pennstatelawreview.org/116/3/116%20Penn%20St.%20L.%20Rev.%20837.pdf>.
[33] Ibid, p. 846.
[34] Ibid, p. 846.

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What this comes down to is for example when a board of directors would decide to sell a company's asset to an individual director without approval of the shareholders, no court would hold that such an board's decision needed to be protected under the business judgment rule, when a shareholder would fight that decision in court. Under the circumstances of the case the court will decide on the weight of the conflict of interest that has turned the shield of the director to a sword of the plaintiff.

II.2.3. Duty to Act in Good Faith

The Delaware Supreme Court declared for the first time in Cede & Co. v. Technicolor Inc.[35] that a set of three fiduciary duties rest on the directors, i.e. the duty of good faith next to the classical duties of loyalty and care. The duty of care and the duty of loyalty encompasses that the director has to act in good faith. A director breaches the duty of good faith, as was held in
In re Walt Disney Company Derivative Litigation[36], when:

> "the fiduciary intentionally acts with a purpose other than that of advancing the best interest of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."

It is deemed an infringement of the duty to act in good faith when the directors had knowledge that they were disregarding their fiduciary duties.[37]

In the Citigroup case it was held that: 'Delaware law does not permit (...) judicial second-guessing of directors' business decisions (...) as long as those decisions were not made in bad faith.'[38]

The element of good faith is to be found in the Delaware General Corporation Law under articles 141 (e), 145 (a) (b) and 102 (b) (7).

II.2.4. Other Directors' Duties

There are more fiduciary duties besides the fore mentioned duties. The duty of confidentiality and the duty of disclosure are two duties that are implied. Under the duties of care, loyalty and good faith it is also understood that there is a duty to keep corporate information confidential.

II.3. Judicial Review

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[35] *Cede & Co v. Technicolor Inc.,* 634 A.2d 345 (Del.Supr. 1993).
[36] *In re Walt Disney Co. Litigation*, 906 A.2d 27, 67 (Del.2006).
[37] Lafferty, W.M., Schmidt, L.A. and Wolfe, D.J., A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law, Penn State Law Review 2012, p. 847, <http://www.pennstatelawreview.org/116/3/116%20Penn%20St.%20L.%20Rev.%20837.pdf>.
[38] *Citigroup Inc. Shareholder Deriivative Litigation*, 964 A. 2d 106 (Del. Ch. 2009).

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The business judgment rule does not only work as a shield to protect directors, but it also works to the benefit of shareholders, as a sword.[39]

As seen above the business judgment rule is based on the reluctance of the courts to second- guess directors' decisions with contingencies as was held by the court of Chancery of Delaware in Solash v. The Telex Corporation[40] that:

> "Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith."

Generally, the presumption of the business judgment rule is exactly what it suggests: a procedural guide as well as a judicial review standard. The business judgment rule serves as a judicial review standard (standard of review) to assess whether the board of directors has acted or behaved in accordance with the applicable standard of conduct; i.e. the fiduciary duties. As explained by the Delaware Supreme Court,

> "the burden falls on the plaintiff to rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care." [41]

The usage of the term presumption is not in the sense that the plaintiff has to prove the infringement of the fiduciary duties, but rather just has to allege facts sufficient to overcome that initial presumption[42] 'by challenging the substantive merits of a board decision';[43] being infringement of fiduciary duties. Thus, the business judgment rule 'is not a presumption that the directors have acted' correctly, 'but rather a commitment not to question the substance of director action when there is no proof that the directors have acted badly'.[44]

If the rebuttal is not successful, then the business judgment rule provides substantive protection to the directors and the challenged decision/action.

But when the rebuttal of the business judgment rule is successful then the burden of proof shifts from the shareholders as plaintiff to the directors as defendants to prove that the challenged decision/action was entirely fair / taken in accordance with their fiduciary

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[39] Manning, B., *The Business Judgment Rule in Overview*, Ohio State Law Journal 1984, Ohio State University, p. 615.
[40] *Solash v. The Telex Corporation* (Del. Ch. 1988).
[41] Ibid, p. 5.
[42] *Reget v. Paige* (2001 WI App 73).
[43] Ibid, p. 6.
[44] Ibid, p. 6.

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duties. [45] Thus, the rebuttal comes down to showing the court sufficient factual allegations that the directors' actions needs to be reviewed at trial. [46]

If the defendants cannot provide the proof that the decision was made pursuant to their fiduciary duties, then the outcome of the case will be for the plaintiff and they will be rewarded damages.

If the defendant proves that f.e. the decision was made with the approval by an independent director or by fully informed shareholders then, if the plaintiff cannot provide any proof of the contrary the case against the directors will be dismissed and the shareholders will be held to pay the procedural cost of the winning side.

An example of the judicial analysis by the courts can be found in *Benihana of Tokyo Inc. v. Benihana Inc.*[47] The Court of Chancery of Delaware firstly referred to that which was held in In re RJR Nabisco Inc. Shareholders Litigation[48]:

> 'The business judgment form of review encompasses three elements: [1] a threshold review of the objective financial interest of the board whose decision is under attack (i.e. independence),
> [2] a review of the board objective motivation (i.e. good faith), and
> [3] an objective review of the process by which it reached the decision under review (i.e. due care).'

Then the Court stated the following judicial consideration:

> 'In this case, I have followed those steps and I have first concluded that a majority of the disinterested and independent directors approved the (...) transaction. Then, I found that the directors acted with a good faith belief that equity financing represented the best method to finance Benihana's Construction and Renovation Plan and that the directors believed equity financing best served the interest of the Company. Finally, after reviewing the process through which the directors approved the transaction, I have found that the directors reached their decision with due care. Consequently, the Board validly exercised their business judgment in approving the (...) transaction. This Court will not disturb that decision.'

II.4. Hindsight Bias

[45] *Emerald Partners v. Berlin* (Del. Supr. 2001); *Cinerama, Inc. v. Technicolor, Inc.* (Del. Supr. 1993).
[46] *Emerald Partners v. Berlin* (Del. Supr. 1999).
[47] *Benihana of Tokyo Inc v. Benihana Inc* (Del. Ch. 2000).
[48] *In Re RJR Nabisco Inc. Shareholders Litigation*, 1989 WL7036 (Del.Ch. Jan. 31, 1989).

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As humans once the bad outcome of a situation is known of an action it is then inevitable that the mind makes the information of circumstances leading to that outcome more prominent. This is referred to as the hindsight bias.[49] This was affirmed by the courts. [50] [51]

II.5. Sub-conclusion

The business judgment rule is a procedural guide as well as a judicial review standard. The business judgment rule serves as a judicial review standard (standard of review) to assess whether the board of directors has acted or behaved in accordance with the applicable standard of conduct; i.e. the fiduciary duties. The business judgment rule works as a shield, which is the presumption that the directors have acted in compliance with their fiduciary duties. The fiduciary duties encompass the duty of care and the duty of loyalty (implies the duty of good faith). As explained by the Delaware Supreme Court,

> 'the burden [of proof] falls on the plaintiff to rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care.' [52]

The usage of the term presumption is not in the sense that the plaintiff has to prove the infringement of the fiduciary duties, but rather just has to allege facts sufficient to overcome that initial presumption[53] 'by challenging the substantive merits of a board decision';[54] being infringement of fiduciary duties. When the rebuttal of the business judgment rule is successful then the burden of proof shifts from the shareholders as plaintiff to the directors as defendants to prove that the challenged decision/action was entirely fair / taken in accordance with their fiduciary duties.[55] Thus the rebuttal comes down to showing the court sufficient factual allegations that the directors' actions needs to be reviewed at trial. [56] In this sense the business judgment rule works as a sword to the benefit of the plaintiff.

If the defendants cannot provide the proof that the decision was made pursuant to their fiduciary duties, then the outcome of the case will be for the plaintiff and they will be rewarded damages.

If the defendant proves that, for example, the decision was made with the approval by an independent director or by fully informed shareholders then, if the plaintiff cannot provide any proof of the contrary the case against the directors will be dismissed and the shareholders will be held to pay the procedural cost of the winning side.

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[49] Veasey, E.N., *What happened in Delaware corporate law and governance from 1992-2004?*, University of Pennsylvania Law Review 2005, p. 1424.
[50] *Production Recourses Group LLC v. NCT Group Inc* (Del. Ch. 2004).
[51] *Litwin v. Allen* (N.Y. Supr. 1940).
[52] Ibid, p. 5.
[53] *Reget v. Paige* (2001 WI App 73).
[54] Ibid, p. 6.
[55] *Emerald Partners v. Berlin* (Del. Supr. 2001); Cinerama, Inc. v. Technicolor, Inc. (Del. Supr. 1993).
[56] *Emerald Partners v. Berlin* (Del. Supr. 1999).

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III. The Business Judgment Rule as Adopted in Germany

Germany was the first European country to adopt the business judgment rule in 2005.

It is tradition in civil law countries to lay down statutory regulations and thus Germany has kept this tradition. Generally, a two-tier board is common for companies even though the statutes give the corporation the freedom to choose either a one-tier or two-tier board structure in its incorporation statutes. On the other hand, the German Public Stock Corporation Act (*Aktiengesetz, 'AktG'*) mandates a two-tier board structure for limited companies.[57]

The primary difference between the American and the German public companies is the shareholder versus the stakeholder approach where in Germany the board is a reflection of the codetermination policy of employees. While in the US the company board is comprised of independent directors, the German board is more a representation of the stakeholders. However, there is a trend developing where the American board is converging with the two-tier board structure in practice by adopting monitoring standards on boards resulting in the delegation of responsibilities to committees. Also independent expertise is consulted in the decision making process. This is referred to as the 1½ board structure.[58]

III.1. The German Business Judgment Rule

Germany transposed the traditional principle of the American business judgment rule. Before the codification of the German business judgment rule the German Federal High Court of Justice, *the Bundesgerichtshof* (*BGH*), introduced it in 1997 in the case *ARAG/Garmenbeck* [59]. It was held that management needs freedom to take decisions, however their actions must not breach their fiduciary duties, which is not limited to 'unlawful acts or unjustified risk-taking', but more than acting on an uninformed basis.

The German business judgment rule is codified in section 93 of the German Stock Corporation Act (*Aktiengesetz, 'AktG'*):

> '(1) In managing the company the members of the management board shall employ the care of a diligent and conscientious manager. There is no breach of the aforementioned duty if in the case of an entrepreneurial decision the member of the management board could reasonably assume to be acting on the basis of adequate information and for the benefit of the company. (2) Members of the management board who breach their duties shall be jointly and severally liable to the company for any resulting damage. In the event of

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[57] Block, D. and Gerstner, A., One-Tier vs. Two-Tier Board Structure: A Comparison Between the United States and Germany, Penn Law 2016, p. 21, <https://scholarship.law.upenn.edu/fisch_2016/1/>.
[58] Block, D. and Gerstner, A., One-Tier vs. Two-Tier Board Structure: A Comparison Between the United States and Germany, Penn Law 2016, p. 40, 50. <https://scholarship.law.upenn.edu/fisch_2016/1/>.
[59] *ARAG/Garmenbeck*, BGHZ 135, 244.

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> a dispute as to whether or not they have employed the care of a diligent and conscientious manager they [the directors] shall bear the burden of proof.' [60]

Under section 93(1) *AktG* the following requirements are listed. Firstly, the duty of care. Secondly, a duty to be diligent and conscientious. However it is broadly established that the German business judgment rule pursuant to §93(1) *AktG* includes inter alia the following five requirements: 1. the director taking an 'entrepreneurial decision', whereas that decision is made 2. 'on the basis of adequate information' 3. in the interest of the company, 4. in good faith, and 5. no conflict of interest (or self-dealing).

These requirements are substantially the same as the duty of care, duty of loyalty and duty to act in good faith, however they are broken down into five elements.

Furthermore, the main difference between the Delaware business judgment rule and the German business judgment rule is that instead of the plaintiff having to rebut that the directors have acted in line with their fiduciary duties, in the German case there is no need for a rebuttal from the plaintiff because the directors, i.e. the defendants, bear the burden of proof pursuant to the article 93 *AktG.*

When a claim is brought against the directors they have to proof that their action or decision is within the borders of the criteria of the German business judgment rule upon which the courts review their liability.[61] If the directors are successful with the presented proof then the court will rule that they have the protection of the business judgment rule meaning that the claim is unsuccessful.

III.2. Acting on an Adequate Informed Basis

As regards the second condition for the business judgment rule, 'acting on the basis of adequate information', there is no infraction of the duties when a managing director took an 'entrepreneurial decision' when he or she 'could reasonably assume to be acting on the basis of adequate information and for the benefit of the company'. Thus there are two sub elements: 'could reasonably assume' and 'acting on an adequately informed basis'.

Firstly, it is not clear whether the terminology 'could reasonably assume', should be defined as a director should refrain from either 'slight negligence or (only) gross negligence'. In *ARAG/Garmenbeck* the court held that under the concept 'reasonably' can be understood as taking an entrepreneurial decision which has been assessed wrongly 'in a complete irresponsible manner'. According to *Deipenbrock* the example given by the court in *ARAG/Garmenbeck* the concept 'could reasonably assume' can be understood to mean 'assume without gross negligence in context of the German [business judgment rule] is an adequate way de *lege lata* to achieve the legislator's goal'.[62]

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[60] Deipenbrock, G., *The 'Business Judgment Rule' and the Problem of Hindsight Bias – Observations from a German Company Law Perspective*, European Business Law Review, Kluwer Law International 2016, p. 208.

[61] Wagner, G., Officers' and Directors' Liability under German Law, Theoretical Inquiries in Law 2015, p. 74-75, < http://din-online.info/pdf/th16-1-4.pdf>.

[62] Ibid, p. 216.

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Under the second subcomponent, which is that the director has to be 'acting on the basis of adequate information' when making a decision, it is understood that the managing director must act on an adequate information basis as well as in the welfare of the company. Otherwise the presumption of gross negligence is applicable to the decision. However, this does not mean that the board of director has to constantly employ advisors or experts before taking a decision. Therefore when evaluating the decision to answer to the elements 'could reasonably assume to be acting on the basis of adequate information and for the benefit of the company', the director must have 'carefully prepare[d] the entrepreneurial decision and adequately assess[ed] the risks related to it in the concrete situation'.

It is easy to say that a decision was a bad one after the fact because the outcome is then known, resulting is 'outcome bias', but when running a business there are risks involved and no one has a crystal ball to predict the future. Thus, when the courts review the decision all the circumstances of the specific case need to be assessed. The business judgment rule cannot be applied rigidly but rather as an elastic band to fit. Substantially this requirement is equal to the duty of care under the American business judgment rule.

III.3. To the Benefit of the Company

The evaluation of the third component of the German business judgment rule, that the decision should be to the welfare of the company, subsequently requires an ex ante point of view. The decision must be sustainably beneficial to the company and contributing to the competitiveness off the business with all its products and services. When applying all the elements of the *ARAG/Garmenbeck* judgment, the director's decision would qualify as gross negligence to the welfare of the company in situations where the board of directors acted reckless.[63]

Substantially this requirement is comparable to the duty of loyalty under the American business judgment rule.

III.4. In Good Faith

The element of good faith of the business judgment rule is not whether the board of directors acted on a reasonable informed basis to the welfare of the company, but that they could believe that their decision was reasonably correct. Even though the terminology good faith is not explicitly stated under § 93 (1) *AktG,* yet it can be derived that there must be no conflict of interest.[64]

Substantially this requirement is equal to the duty of good faith that is considered to fall under the duty of loyalty under the American business judgment rule.

III.5. Conflict of Interest

According to the German lawmakers the actions of the board of directors must be without conflict of interest and straightforward self-interest. However, there might be some

[63] Ibid, p. 219.
[64] Ibid, p. 221.

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exception to the rule when the interested director had disclosed his interest to the boards in compliance with the fiduciary duties as has been described above. [65]

Substantially this requirement is comparable to the duty of loyalty under the American business judgment rule.

III.6. Debates

Since transposing the business judgment rule in 2005 there have been many debates as to its implementation thereof in practice; essentially, regarding its effectiveness to limit directors' liability. Over the years §93 (1) *AktG* has been applied, yet depending on how wide or narrow the components of the German business judgment rule has been interpreted when assessing the range of its protection of directors from liability there has been much debates about the first three components: entrepreneurial decision, acting on adequately informed basis which can be reasonably assumed. Nonetheless the German courts are well on their way to create defined standards even though, the American courts have created the business judgment rule they still do not have a common definition of it nationwide. Which is understandable because the business judgment rule must remain an approach so that it can be adapted and developed in its application to remain relevant in the future; this is possible through case law.

When the components of the German business judgment rule have not been met then the director is found to be liable for the damages, which is paid out by the mandatory insurance that the company has to contract for just such situations. Therefore, the damages are always paid, which ensures that the 'injured' party is guaranteed a payout when the claim is successful.

III.7. Sub-conclusion

The German business judgment rule is similar to the Delaware business judgment rule, but where they differ is that under the German law the burden of proof rests upon the directors when a claim is brought against them. This means that the presumption part of the Delaware business judgment rule is (re)moved so that when a claim is brought against the director there is no rebuttal by the plaintiff (of the presumption that the director had acted in compliance with his or hers fiduciary duties) required, but rather that the burden of proof is placed directly upon the directors to prove that they acted in compliance with their fiduciary duties.

IV. Directors' Liability in the Netherlands

In the Netherlands there is no business judgment rule present, however there are provisions for directors' liability.

As stated above, the Netherlands, like Germany, is a civil law jurisdiction. This means that Dutch law is mostly codified in statutory provisions. Conventionally there is a distinction made between public and private law. Dutch private law is mostly laid down in the Dutch Civil Code (DCC), but can also be found in case law. Corporate Law is laid down in Book 2 of the DCC. Some of the rules are mandatory and others can be deviated

[65] Ibid, p. 221.

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from. Such a deviation can be made in the articles of association. Apart from the statutory and case law there is the Corporate Governance Code.

According to Assink, the judicial review of corporate behavior in the context of the corporate policy pursued within Delaware's Corporate Law seems to have evolved beyond the Company Law of the Netherlands.[66] This is understandable as the standard of review for directors liability in the US has been developing since the early 1800, while the Netherlands started with such in 1997, so the US has hadalmost two centuries' head start. As an example, he stated that in Corporate Law statements there is usually a lot more attention paid to the fiduciary duties of the board of directors and the purpose of the entrepreneurial policy freedom. One could argue that within the Dutch Corporate Law there is already a build-in supervisory system in the form of the supervisory board which may explain the difference. In this chapter the directors' internal liability within Dutch corporate law will be delineated.

IV.1. Dutch Board Structure and Practices

Before tackling the Dutch directors' liability a quick view of the Dutch board structure and practices will be given. Similar to Germany, and most continental countries, the Netherlands also has a two-tier board structure. This is due to the fact that the Dutch governance model is based on the two-tier board structure for public companies.[67] However seeing the developments in business in the globalized economy the option has been created to have a one-tier board structure for public companies, but such is only possible with permission from the minister of justice.[68]

Pursuant to article 2: 129/239 paragraph four DCC the articles of incorporation can stipulate that the board must behave according to the instructions of a company body that defines the general lines of the policy to be pursued (further specified in the articles of incorporation). One could speak here of limited instruction right. In addition, when shareholders have the power to– because of its controlling position of power in the form of the general meeting of shareholders- dismisses the board of directors in accordance with article 2: 134/244 DCC, it will be de facto difficult to evade the wishes of the shareholders regarding the conduct or business policy. One could speak here of instruction power. This especially plays a role in intra-group relationships. In which instance the board of the company at the head of the concern generally has the duty to put the interest of the company at the center when executing its duties.[69]

IV.1.1. Management Board

[66] Assink, B.F., *Rechterlijke toetsing van bestuurlijk gedrag: Binnen het vennootschapsrecht van Nederland en Delaware*, Erasmus University Rotterdam 2007, p. 13.
[67] Book 2: 158 -164 Dutch Civil Code; Gool van, p. 2.
[68] Book 2: 156 Dutch Civil Code; Raaijmakers, p.207
[69] Assink, B.F., Kan de Delaware business judgment rule wat betekenen voor het Nederlandse vennootschapsrecht, specifiek het enqueterecht?, , Wolter Kluwer 2008, p. 35 -36, <https://www.navigator.nl/document/inodf10b60522b3b02b6d897c931f10f550d/journaal-ondernemingsrecht-bf-assink-kan-de-delaware-business-judgment-rule-wat-betekenen-voor-het-nederlandse-vennootschapsrecht-specifiek-het-enqueterecht-ondernemingsrecht-2008-66-p-230-236?ctx=WKNL_CSL_48>

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Similar to Germany, the board of directors is responsible for running the company and setting out future strategies.[70] Also, like Germany, the Dutch have the stakeholder orientation so that the board of directors have to take the interest of not only the shareholders, but also of other actors, like the employees and creditors and not to forget the interest of the company as a whole, into account. However, there is no mandatory codetermination as is present in Germany (see Chapter III).

IV.1.2. Supervisory Board

The supervisory board is, just as in Germany, responsible for supervision and advising the board of directors as well as overseeing the interest of the company.[71] The supervisory board can inter alia appoint directors of the managerial board as well as suspend and terminate their employment depending on the statutes. Correspondently it is mandatory for the board of directors to provide the supervisory board with information so that they can perform their supervisory duties.[72] The supervisory board is not a fulltime occupation and thus they are not on the premises on a daily basis and or apart of the daily management.

IV.2. Liability of the Board of Directors

Dutch law provides a general duty of proper management (performance) towards the company. The directors' (joint and several) internal liability provisions is to be found in article 2:9 Dutch Civil Code (DCC):

> 'Towards the company each director is required to proper performance of management duties, and is jointly and severally liable should he or she be deemed subject to serious reproach',[73] unless he or she has not been negligent in taking measures to avert the consequences.[74]

This article is the codification of the 'serious reproach' standard which had been developed in case law and is used to establish directors' liability towards the company.[75] Besides the serious reproach standard there is the standard of reasonableness and fairness is laid down in article 2:8 DCC. The board has the task of fulfilling its powers in a proper manner, both with regard to the company policy (*vennootschappelijkbeleid*) and the corporation policy (*ondernemingsbeleid*), and also to comply with its duties.

In matters concerning judicial review of administrative behavior in the face of company and corporation policy, the question is usually not whether the management board has the authority to make a business (policy) decision, but whether or not the management board has made a business decision in an inadequate manner.[76]

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[70] Book 2:129 Dutch Civil Code.

[71] Book 2:140, 158-164 Dutch Civil Code; Postma, p. 3-5.

[72] Book 2: 141 Dutch Civil Code.

[73] Google translate; Pham, Directors' Liability, p. 60.

[74] Google translate.

[75] *Staleman v. Van der Ven*, HR 10 januari 1997, NJ 1997, 360.

[76] Assink, B.F., Kan de Delaware business judgment rule wat betekenen voor het Nederlandse vennootschapsrecht, specifiek het enqueterecht?, , Wolter Kluwer 2008, p. 9-10., <https://www.navigator.nl/document/inodf10b60522b3b02b6d897c931f10f550d/journaal-

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Furthermore the application of the standard of 'serious reproach' is not only utilized to establish directors' liability towards the company, but it is also applied to the review directors' liability towards third parties: creditors and shareholders pursuant to article 6:162 DCC and in the event of bankruptcy pursuant to article 2:138/248 DCC.

More on the assessment of directors' liability in paragraph 4.3 and 4.4.

IV.3. Enquêterecht and the Enterprise Chamber

In the Netherlands there is a distinct procedure referred to as the inquiry (*enquête*) procedure before the Enterprise Chamber (*Ondernemingskamer*) for conflicts in the field of corporate law. For instance, conflicts between shareholders and the board of directors or amongst the shareholders themselves which can lead to the detriment of the company.

There are various motives for starting an *enquête*, such as: to get more insight within the organization (transparency); finding out who is responsible for violations, abusing authority or mismanagement; resolving conflicts and restoring healthy relationships within the company.

Because the Enterprise Chamber is established for taking quick and decisive decisions in problems – as mentioned above- between parties within the company it is a preliminary relief court and thus falls outside the ambit of this research. As the Enterprise Chamber does not apply the serious reproach standard but establishes *wanbeleid*, i.e. mismanagement, and does not establish (internal) liability of directors.

IV.4. Judicial Review

The position of power and trust held by the board of directors implies, among other things, that they must be able to account to the court about the way in which they have been giving input and content to the business policy, and in what context the interest of the company is represented. The courts will apply accountability in an increased extent as the shareholders' inclusion lessens.[77]

Central to Dutch Corporate Law is the concept referred to as the 'interest of the company'. This principle represents the primary aim of the board. When making business considerations – if the board is actually doing such- it is not quantifiable with a fixed content on which the judge can easily test the administrative behavior on the basis of 'the company's interest'. This is not an unambiguous and independent manageable test tool, but rather a guideline for the management in conducting the company (*vennootschappelijk)* and corporation (*onderneming*) policy, as well as a legal instrument concept judges can use if the board of directors is opposed; to be held accountable for their actions. It is a meaningful but rather abstract starting point for further analysis, where (assuming a focus on continuity of the company and corporation policy) the aim must be

ondernemingsrecht-bf-assink-kan-de-delaware-business-judgment-rule-wat-betekenen-voor-het-nederlandse-vennootschapsrecht-specifiek-het-enqueterecht-ondernemingsrecht-2008-66-p-230-236?ctx=WKNL_CSL_48>.

[77] Meubeliring Beheer, OK. 9 march 2000 Willem III; *Franis v. United Jersey Bank (N.J. 1981).*

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to achieve optimal returns from investments made in the long(er) run, for the benefit of the company, especially shareholders and employees.[78]

However, accountability starts in the first place towards the general meeting of shareholders and thus is why courts give weight to disclosure and approval by the general meeting of shareholders. For instance, in the Uni-Invest case[79] it was held that it is up to the general meeting of shareholders of the company to weigh the interests. It is of importance to handle a balanced system of checks and balances via intra-company structures, in modern terms, improved corporate governance, can contribute to promoting responsible governance.[80]

Business policy considerations are usually based to a large extent on less tangible aspects such as vision, creativity, experience of decisiveness, courage, intuition, market sense, assessments of a belief in predictable and difficult foreseeable developments. The board must, as an entrepreneur, often make estimates of variables, appraise future situations, value opportunities and chances. This logically involves risks. That is the essence of doing business. The prudential accuracy in advance of such business policy considerations is difficult to measure and verify.[81] For this reason the judge does not have a finely – meshed set of objectives, black-and-white criteria. Entrepreneurship is not an exact science.[82] Which is in line with the Delaware perspective and the basis of the business judgment rule as delineated in Chapter II.

That is why the Dutch legislator based the directors' liability on an open norm (in their civil code under article 2:9 as translated in paragraph 4.2 of this thesis).

When determining the internal liability of a director or the board of directors the Dutch courts uses the serious reproach (*ernstig verwijt*) standard as an assessment standard to review whether the director has acted or preformed properly in fulfilling (*behoorlijke taakvervulling*) his or her duties vis-à-vis the company. Which is a behavioral norm.[83] The required elements for the behavioral norm for directors can also be found in article 2:9 DCC. However, article 2:9 does not provide how the courts must apply the elements when reviewing a challenged decision. Before the codification utilization of the 'serious reproach' standard was developed in case law of which the first was the *Staleman v. Van de Ven* case.

In Staleman v. Van de Ven[84] case it was held that judges must perform a multi-layered evaluation per case with its specific circumstances; which Pham refers to as a multi-faceted revision norm.[85] Therefore in addition to the behavioral (norm) factors it was held that

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[78] Wulf, p. 529.
[79] Uni-Invest case, OK. 19 December 2000.
[80] Ibids.
[81] Wulf, pg 494.
[82] Getronics, OK. 2 September 2004.
[83] Pham, N.T., Directors' Liability, Wolters Kluwer 2017, p. 55, <https://www.navigator.nl/document/idc6b4444c19f247d8b203463b48f9b749?ctx=WKNL_CSL_2372>.
[84] Supreme Court, 10 January 1997, ECLI:1997:ZC2243 (HR 10 januari 1997, NJ 1997, 360).
[85] Pham, N.T., Directors' Liability, Wolters Kluwer 2017, p. 58, <https://www.navigator.nl/document/idc6b4444c19f247d8b203463b48f9b749?ctx=WKNL_CSL_2372>.

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the courts must take into account 'all relevant circumstances' to the specific case when analyzing the directors' liability; which are the contextual factors. Such circumstances can be:

- the 'nature of the company's activities';
- the related risks;
- the structure of tasks and duties under the directors themselves;
- 'any relevant guidelines to which management should adhere';
- the available information;
- 'the care and competence expected from management'. [86]

Furthermore, in *Staleman v. Van de Ven* it was held that serious reproach – being the standard in establishing directors' liability- is when the director has breached '(internal) norms' which are in place to the protection of the company.[87]

IV.5. Marginal Review

In the Netherlands the judicial review of the board of directors' behavior is said to be marginal and referred to as the 'marginal review'.

The meaning of this concept is that the judge respects the board of directors' administrative freedom and thus only intervenes when it is sufficiently clear by objective measures that they have used their administrative freedom in such a way that it does not deserve to be respected (improper performance).[88] Even though the marginal review regards the burden of proof (*bewijslast*) and not the procedure law of burden of proof (*bewijsrecht)* pursuant to the business judgment rule, yet de facto this gives the same practical result as the presumption[89] of US the business judgment rule that the courts will only review the case when the contrary of the presumption is shown. De facto both start with a protection of the directors regarding the challenged action.

Conceptually the opposite of marginal review is a full or substantial review. Full judicial review is the fundamental form of review in Dutch Civil Law.[90]

In contrast to the marginal review by the courts the general meeting of shareholders and/or the supervisory board can fully review the policies. [91] After internal oversight by

[86] Timmerman, L., Company Law, Wolter Kluwer 2006, p. 481, <https://www.navigator.nl/document/inod5ae132c389da76ba0355566bc93dfcd4?ctx=WKNL_CSL_104>.
[87] Ibid.
[88] Assink, B.F., Kan de Delaware business judgment rule wat betekenen voor het Nederlandse vennootschapsrecht, specifiek het enqueterecht?, , Wolter Kluwer 2008, p. 44, <https://www.navigator.nl/document/inodf10b60522b3b02b6d897c931f10f550d/journaal-ondernemingsrecht-bf-assink-kan-de-delaware-business-judgment-rule-wat-betekenen-voor-het-nederlandse-vennootschapsrecht-specifiek-het-enqueterecht-ondernemingsrecht-2008-66-p-230-236?ctx=WKNL_CSL_48>.
[89] The presumption is that the courts will presume that the directors acted in compliance with their fiduciary duties and only will review the challenged action when the contrary is shown.
[90] Timmerman (2003), 557.
[91] Ok. 28 december 2006 (KPNQwest), ro. 3.41-3.49 en Ok. 13 maart 2003 (Corus Nederland).

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the supervisory board and approval by the shareholders through the general meeting there remains external review (marginal review) by the court.[92]

Within Dutch Company (Case) Law the reasonableness test (*redelijkheidstoets*) is the traditionally used form of 'marginal review'. [93] The reasonableness test is a common and within Dutch company law traditionally used form of marginal review. Application of the reasonableness test assumes - as justification for an exception to the main rule of full judicial review – that the board of directors have a margin of policy freedom. The view expressed in Dutch company law about the reasonableness test in the core is that the judge starts with the theoretical consideration of the 'reasonable acting director in similar circumstances' as a functional comparing typology from an ex ante perspective to shift into an objective assessment whether the directors could reasonably have believed that by acting in that way they have acted in the interest of the company. On the basis of the reasonableness test is the criterion for establishing improper performance (*onbehoorlijke taakvervulling*) ex article 2:9 DCC. [94]

In the *Verto v. Drenth*[95] case The Hague Court of Appeals held that improper performance (*onbehoorlijke taakvervulling*, see paragraph 4.2) in the meaning of article 2:9 DCC is – apart from failure to comply with the statutory duties and obligations provided for directors and supervisory directors - in the opinion of the court only when the director personally can be blamed ('serious reproach') for the way in which they have fulfilled their duties. It must be a serious shortcoming, a situation in which no reasonable thinking and preforming director or supervisory director would have done.[96]

In the Laurus case the Supreme Court[97] held that proper performance (*behoorlijke taakvervulling)* towards the company, apparently in the light of article 2:9 DCC, is the way in which a reasonably competent and reasonably performing director who should have performed the task under the circumstances.

A 'reasonable thinking and preforming director would have done' criterion, as concluded by the courts in the above-mentioned cases, is similar to one of the elements of the fiduciary duties under the business judgment rule.

Another principle that is traditionally used in Dutch Law when assessing liability is the *zorgvuldigheidsbeginsel* which translates to the due care principle. Maeijer considered that in the process of decision-making a distinction must be made between the material content of the policy and the underlying policy decisions that have been reached, for example in light of formal rules regarding the decision-making process and the

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[92] Assink, B.F., Kan de Delaware business judgment rule wat betekenen voor het Nederlandse vennootschapsrecht, specifiek het enqueterecht?, , Wolter Kluwer 2008, p. 43. <https://www.navigator.nl/document/inodf10b60522b3b02b6d897c931f10f550d/journaal-ondernemingsrecht-bf-assink-kan-de-delaware-business-judgment-rule-wat-betekenen-voor-het-nederlandse-vennootschapsrecht-specifiek-het-enqueterecht-ondernemingsrecht-2008-66-p-230-236?ctx=WKNL_CSL_48>.

[93] Ibid., p. 45.

[94] Assink, B.F., *Rechterlijke toetsing van bestuurlijk gedrag: Binnen het vennootschapsrecht van Nederland en Delaware*, Erasmus University Rotterdam 2007, p. 53-54.

[95] *Verto v. Drenth* Gh.'s Gravenhage, 6 April 1999.

[96] Ibid.

[97] *Laurus Laurus v. UB Holding B.V. a.o.,* HR 8 April 2005, NJ2006, 443, ro. 38.

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procedural standards that preceded the decision consultations. In connection with the latter one speaks of the *'in acht te nemen (formele)* zorgvuldigheid'. The review by the Court on the '*formele zorgvuldigheidsbeginsel*', which translates to formal due care principle, can but does not have to be less than a substantive assessment.[98] This due care requirement is similar to the duty of care pursuant to the Delaware business judgment rule.

According to Potjewijd and Kleipool[99] mal administration occurs when decisions are in conflict with elementary principles of responsible entrepreneurship. These elementary principles refer not only to the decision-making process (due care requirements = *zorvuldigheidseisen*), but also to the content of the company decision (goal achievement requirements). It is generally assumed that the courts can fully test the conducted policy against the due care requirements, but that the content and efficiency of the company decision is only tested marginally. Also Mendel and Oostwouder find that the conflict with these elementary principles are easier in cases of procedural error than cases of substantive decisions that simply have a certain degree of discretion.[100] Furthermore, in this respect Schilfgaarde and Winter[101] defend that the expression struggle with elementary principles of responsible entrepreneurship are understood to mean on the one hand the entrepreneur is given a wide discretion regarding decision-making, but on the other hand, that it is carefully checked on the basis of what details and what procedures he has taken these decisions.

IV.6. Elements to Serious Reproach

In this paragraph the elements of serious reproach are described on the basis of empirical research of Dutch directors' liability.[102] The standard of serious reproach, which is an open norm, is used for various legal procedures of directors' liability[103] as a systematic legal framework to analyze directors' liability. As mentioned above the standard of serious reproach is an open norm and open norms gives flexibility, however according to scholars Assink and Kroeze this increases the uncertainty of the courts' decisions. Nonetheless, out of empirical data from research the opposite is concluded by Pham. Her research established that the Dutch Supreme Court decisions are consistent and that the court considers the standard of serious reproach in a decision model:

1. Identification of the breached norm (norm violation);
2. Objective examination of the extent to which the breached norm can be reproached (degree of reproach);

[98] Asser, C. and Maeijer, J.M.M., *Vertegenwoordiging en rechtspersoon: de naamloze en de besloten vennootschap,* Jjeenk Willink Deventer 2000, p. 819.
[99] Potjewijd, G.H., and Kleipool, R.H., *De nieuwe macht van de kapitaalverschaffer*, Ondernemingsrecht 2007, p. 136.
[100] Mendel, M.M, and Oostwouder, W.J., *Hoofdzaken NV en BV*, Kluwer Deventer 2007. (2007), p. 94.
[101] Schilfgaarde, P. van, and Winter, J.W., *Van de BV en de NV*, Kluwer Deventer 2006, p. 337-338.
[102] Pham, N.T., Directors' Liability, Wolters Kluwer 2017, < https://www.navigator.nl/document/idc6b4444c19f247d8b203463b48f9b749?ctx=WKNL_CSL_2372>.
[103] I.e. directors' liability to the company pursuant to Article 2:9 DCC, external liability of directors to third parties for wrongful acts in the meaning of Article 6:162 DCC and in the event of bankruptcy pursuant to Articles 2:138/248 DCC.

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3. Taking into account all the relevant circumstances of the case, including the arguments raised by the defense (view of severity of norm violation together with all relevant circumstances).[104]

The decision model utilizes all relevant circumstances of the case which provides the behavioral factor in combination with the contextual factor to establish whether the challenged decision taken by a director constitutes a breach of an applicable norm to the protection of the company, for which the director can either be individually or conjointly be blamed.[105]

Directors' liability is centered around the breached internal norms through specification of directors' duties or the performance of these duties.[106] According to Pham the foreseeability of damage to the company is an important contextual factor or relevant circumstance for directors' liability in any case.[107]

The analysis of serious reproach is continued under Chapter V.

IV.7. *Pro and contra* a Dutch Business Judgment Rule

As we have seen above the US and German business judgment rule differs on certain points, inter alia regarding the burden of proof; i.e the removal of the rebuttal requirement and going straight to laying the burden of proof on the directors, yet substantially it comes down to the same required elements of the business judgment rule that is reviewed by the courts.

The main arguments for and against the introduction of a Dutch business judgment rule will be presented below.
The prominent scholars pro the introduction of the Dutch business judgment rule are Assink,[108] Timmerman and Kroeze[109], while the main scholars against it are Deelen[110] en Calkoen.

The primary arguments pro the introduction of the Dutch business judgment rule are to:
1. prevent 'scared' directors';
2. ensure legal certainty;
3. reduce hindsight bias in judicial review.

IV.7.1. Preventing 'Scared' Directors: *Pro and Contra*

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[104] Pham, N.T., Directors' Liability, Wolters Kluwer 2017, p. 59,<https://www.navigator.nl/document/idc6b4444c19f247d8b203463b48f9b749?ctx=WKNL_CSL_2372>.
[105] Ibid, p. 58.
[106] Ibid, p. 60.
[107] Ibid, p. 66.
[108] Assink, B.F., *Rechterlijke toetsing van bestuurlijk gedrag: Binnen het vennootschapsrecht van Nederland en Delaware*, Erasmus University Rotterdam 2007.
[109] Kroeze, M.J., *Bange Bestuurders, Oratie Rotterdam 2005,* Ondernemingsrecht 2006.
Lafferty, W.M., Schmidt, L.A. and Wolfe, D.J., A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law, Penn State Law Review 2012, <http://www.pennstatelawreview.org/116/3/116%20Penn%20St.%20L.%20Rev.%20837.pdf>.
[110] Solinge, G. van, *Aansprakelijkheid van bestuurders en commissarissen*, Wolters Kluwer Deventer -2017. p. 721.

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With the Dutch business judgment rule the directors will have a safe haven, more over they will have the more control as to show that they acted in line with their duties, which reduces the fear of liability.

According to Kroeze, the fear of liability can harm the company as the directors will be hesitant to take risk for higher returns in investment, f.e. because the directors are fearful they will choose a less risk involved investment resulting in X profits as when they had taken the risky investment the profit could have been X + Y.

Furthermore, Assink argues that there is uncertainty regarding the applicable open norms, because the exact scope was not clear so that the directors lacked insight and overview of his or her liability and thus resulted in fear in executing their tasks. With the introduction of a Dutch business judgment rule according to Assink the Dutch company law would gain a concrete judicial review standard within the context of directors' personal liability. Thus, there would be more structure in the review standard, and this would lead to predictability of results of judicial review of directors' actions resulting in liability.

Contra argument is that there is no need for directors to be fearful about eventual liability, especially the bona fide directors because of the high threshold of proof for personal liability and the marginal review by the court. According to Deelen a Dutch business judgment rule would not add to the current range of standards 'serious reproach', 'good governance', 'in breach of elementary principles of responsible entrepreneurship' and 'the reasonably competent and reasonably acting director'. As the business judgment rule also contains concepts that can be interpreted broadly. Consider, for example, the entrepreneurial or corporate decision criterion. When is this the case? Is this not a gray area as well? Moreover, what is to be understood under the conflict of interest element? The business judgment rule means that the decision may not be taken under the influence conflict of interest, or should the director not have any conflict of interest in the decision at all? These are also vague norms that must be filled in according to the circumstances of the case. Just like the open norms that play a role in liability on the basis of serious reproach. Thus, with the introduction of a Dutch business judgment rule the problem of vague norms would only move from one framework to another. Deelen argues that he believes that a certain degree of vagueness is not a problem at all. Removal of open norms from the legal system is impossible. All the more because open norms ensures the practical application of the law. The context of an open norm gives meaning to the norm. An example is the term 'good governance'. It is impossible to give a conclusive definition for this, since it depends on the circumstances of the case. Open norms and rules are passive, because they lack context. Only when it is applied in practice does the open norm or rule filled in and gets meaning. Another example; the meaning of the open norm 'reckless' is not clear without the context. Because the context determines the meaning of 'reckless', it does not mean that the term is unpredictable to understand but takes circumstances into account. The business judgment rule will not remove the fear from directors. Doctrines, application in practice and case law must make it clear to directors that the threshold of liability protects them. The principle of the law, in both the Netherlands and in Germany, after all, is that bona fide directors have nothing to fear. The director who did everything the way he thought to the best of his knowledge as to be correct, where there was no inkling of anything else until suddenly the outcome was wrong, need not to be afraid of personal liability. Judges do not review

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liability lightly and do not just pass the liability verdict. Deelen argues that the introduction of the business judgment rule will not remove the fear of directors but will cause more uncertainty and create new problems.

IV.7.2. Legal Certainty: *Pro and Contra*

This second argument which has proponents of the introduction of the business judgment rule put forward is partly related to the first argument. As the business judgment rule provides the directors with guidance on how to prevent liability by looking at the conditions for application of the business judgment rule.

According to Deelen this is partially a good thing. The condition of the business judgment rule, such as careful preparation of decisions and decisions without conflict of interest are positive for the company. However, this does entail a risk of checking-off a checklist-behavior. The director has only to ensure that a decision seems sufficiently prepared. But this does not mean that the director actually did so. For example, the director could ask for external advice without actually following it and knowing that the advice would not be used but does so only for the show. Or the fabrication of documentation afterwards.

Introduction of the business judgment rule would blur the distinction between the behavioral norm and the reviewing (norm) standard. The behavioral norm determines how the directors should behave namely as carful (*zorgvuldige*) directors. The reviewing standard in article 2:9 DCC is that directors are liable when they have not behaved as a careful director and thus have violated the code of conduct resulting in serious blame or serious reproach. Thus the court first tests the behavioral norm of article 2:9 DDC before the accountability assessment. The behavioral norm is not always the same as the assessment criterion, but differs, for example, if the court cannot determine the imputability or if an individual director manages to exculpate him- or herself. The imputability criterion is part of the liability standard. The directors violated the behavioral norm rather than the liability norm. For example, it is possible the director has executed his duties improperly (violation of the behavioral norm), however not liable (no violation of the review (assessment) standard). The behavioral norm 'good governance' (*behoorlijk bestuur)* contains a certain degree of vagueness. The circumstances of the case give meaning to this norm. it is not immediately clear what the norm 'good governance' is exactly. Yet that is precisely the power of this behavioral norm, because it differs per case (situation). Both the practical application of law as the law are not static. The current standard of conduct places an appropriate degree of responsibility on the directors. The director needs to ask him -or herself in every new situation if he or she is acting as a good director (principle of good governance).

Deelen continues to say that the blurring of the distinction between the behavioral norm and the reviewing (norm) standard with the introduction of the business judgment rule will lead to directors with a lesser sense of responsibility. Deelen continues that this is not the fault of a director, but rather a logical consequence of formalism and an abundance of rules. Morality requires directors not to have a rule book or checklist to follow, but they must actively be involved in their duties and must ensure adequate quality.

As the court will not be able to substantially review the case due to the protection of the business judgment rule.

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IV.7.3. Reduction of Hindsight Bias: *Pro and Contra*

The last main argument for the introduction of the business judgment rule is the that it will reduce the risk of hindsight bias in the court judgment. Hindsight bias is the phenomenon that results from a particular decision or act, which in retrospect appears to be foreseeable. It involves the tendency to overestimate the extent to which the person concerned - f.e. the director- an event could have occurred. Thus, hindsight bias ensures that the judge has his knowledge of the negative result of the decision, f.e. bankruptcy of the company, in its judgment. This while risk business policy considerations that do not work out well for the company, by no means mean that it was a bad business decision policy consideration at the moment the director makes these decisions. The business judgment rule can serve as an instrument for the court that to reduce the risk of hindsight bias in their judgment.

Deelen agrees with this argument that introduction of the business judgment rule in the Netherlands reduces the risk of hindsight bias. Yet he remarks that the business judgment rule is only one of a broader range of restrictions strategies that the judiciary and the legal practice can use to reduce the risk of hindsight bias.

The arguments *pro and contra* have all been refuted by the data from the empirical study done by Pham delineated in the beginning of this chapter. The real issue is in my opinion the threshold of proof that is required on which I will further discuss in Chapter V.

IV.8. Directors and Officers Insurance

Generally, directors can adjust their personal liability risk by having the company take out an insurance policy, referred to as the Directors and officers insurance (D&O). This is widely practiced within the corporate world. This instrument proves to be of importance to directors as it allows them to exercise some control over the uncertainty of future claims. This instrument also offers the means to settling disputes early and (if possible) outside of the courtroom so that exposure to public opinion next to reducing the amount of exposure to financial damages. [111] However, it has been established that if an annual statement is incorrect and even misleading, this can also cause a problem for upholding the D&O insurance by the insurance company. The annual accounts of the company are often required to be submitted to the insurer when applying for the insurance. If this information is incorrect, the insurer can cancel the insurance. Pursuant to article 7:928 in conjunction with 930 DCC, the insurer can cancel the insurance agreement when it is evident that the true state of affairs of the company were not disclosed or should have been disclosed or made known. Thus, depending on the nature of the misleading nature of the financial statements, the insurer is not obligated to fulfill the policy payment. Both in the US and in the Netherlands, f.e. Ahold and KPNQuest, have in practice had insurers invoke cancellation or annulment grounds when the annual accounts have turn out to be misleading.[112]

IV.9. Sub-conclusion

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[111] Assink, B.F., Ginneken van, M., Timmerman, V. en Vletter-van Dort, H., *De vele gezichten van Maarten Kroeze's 'bange bestuurders'*, Wolters Kluwer 2017, p. 476-477.

[112] Strik, D.A.M.H.W., *Grondslagen Bestuursaansprakelijkheid, Een Maatpak voor de Board Room*, Kluwer Deventer 2010, p. 169-170.

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The Dutch courts apply the standard of serious reproach to review the challenged decision or action undertaken by the director(s). Yet the judicial review is considered to be marginal (marginal review), because the courts will only intervene when it is sufficiently clear by objective measures that the directors have used their administrative freedom in such a way that it does not deserve to be respected. Which means that the courts will only go on to review a challenged action undertaken by the directors when there is sufficient proof that the director's discretionary freedom cannot be respected. Even though the marginal review regards the burden of proof (*bewijslast*) and not the procedure law of burden of proof (*bewijsrecht*) pursuant to the business judgment rule, yet de facto this gives the same practical result as the presumption[113] of US the business judgment rule that the courts will only review the case when the contrary of the presumption is shown. Thus de facto both start with protection of the directors regarding the challenged action. However in the case of the US business judgment rule the threshold of the required proof is lower (as only a rebuttal is required) than that which is required in the Dutch courts. In Dutch law the directors owe proper performance of their managerial duties towards the company. Furthermore, the court have to take into account the circumstances of the case when reviewing the challenged action. Aside from the serious reproach standard the standard of reasonableness and fairness (*redelijkheid en billijkheid of goede trouw*). Basically, it comes down to how a reasonably thinking and performing director should have performed the task under the circumstances of the case. This is similar to one of the elements of the fiduciary duties under the Delaware business judgment rule. Along with the standard of serious reproach and the standard of reasonableness and fairness another element that traditionally plays a role in assessing liability is the *zorgvuldigheidsbeginsel* or *zorgvuldigheidseisen*, which is the due care principle or due care requirements. This due care requirement is similar to the duty of care pursuant to the Delaware business judgment rule.

V. The significance of the Duty of Loyalty

Whether it is Delaware, Florida or New York directors of a company have certain duties toward their company and its shareholders. These duties are referred to as the fiduciary duties. The fiduciary duties comprise of the duty of care and the duty of loyalty. Several jurisdictions consider the duty of good faith and fear dealing to fall under the duty of loyalty. Thus, the duty of loyalty is larger in scope. The duty of loyalty requires directors to act in good faith and in the best interest of the company above their own personal interest. That means that directors have to abstain from putting their own interest above that of the company.

In Delaware the duty of loyalty takes a special position as it cannot be contractually limited and there is no indemnification for infringement of the duty of loyalty this is laid down in article 102 (b)(7) DGCL, which states that the fiduciary duty of loyalty may not be waived or limited. Even though, infringement of the duty of care can be waived or limited, within the last decade the courts have shifted away of this by deciding that the

[113] The presumption is that the courts will presume that the directors acted in compliance with their fiduciary duties and only will review the challenged action when the contrary is shown.

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duty itself cannot be waived as was held in *Malpied v. Towson*[114] and Emerald Partners v. Berlin[115].

Infringement of the duty of loyalty, may inter alia occur in case of:

- conflict of interest: when (a) director(s) has (an) interest(s) in the presented decision to the company;
- self-dealing: when (a) director(s) takes an opportunity to his (their) own benefit instead of presenting it to the company;
- misappropriating company's assets: when (a) director(s) use(s) company's assets for non-business proposes without approval or disclosure.

It is only allowed for a director to have conflict of interest when the remaining directors who have no conflict of interest, referred to as disinterested directors, have approved the decision in question after being informed of the conflict of interest and the related material facts to the transaction and of the particular directors' relationship or interest are made known to them. However, approval is very unlikely when it is not to the benefit of the company.

The considerations regarding 'interested directors' by the courts has been codified in article 144 (a) DGCL, but the article is given context in legal practice. Some practical examples of infringement of the duty of loyalty are:

- In the *Shocking Technologies, Inc. v. Michael, et al*[116] case the company sued the director Michael for dissuasion of the only potential investor from investing. The director also shared confidential company information with this investor. Moreover, he used the company's critical need for financing to pressure the other directors into meeting this investor's demands, while at the same time he was coercing with the investor not to go ahead with the financing until he gets better conditions including a board seat. By inter alia disclosing to this potential investor that he was the only one at that time Michael put the company in a bad bargaining position and effected the company negatively. The court held that the actions undertaken by Micheal constituted a breached his fiduciary duty of loyalty to the company as he was working against the company's best interest, i.e. to obtain financing, and his disclosure of confidential information was to the company's detriment.
- Also, *Kahn v. M&F Worldwide Corp.* case regarded conflicting circumstances in a merger and acquisition decision. The court concluded that 'the director in question had ties to the person whose proposal or actions he or she is evaluating that are sufficiently substantial that he or she could not objectively discharge his or her fiduciary duties'.[117] Unless the director had shown that a self-dealing decision was in its whole fair to the company.

[114] *Malpiede v. Towson,* 780 A.2d 1075, 1095 (Del.2001).
[115] *Emerald Partners v. Berlin,* 787 A.2d 85, 92 (Del. 2001).
[116] *Shocking Technologies, Inc. v. Michael, et al,* Del. Ch. 01 Oct. 2012.
[117] *Kahn v. M&F Worldwide Corp.* Del. Supreme Court no. 334, 28 March 2014.

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Delaware Courts have encouraged interested directors to put in place procedural safeguards, f.e. to involve an independent and impartial advisory body, to help ensure fair and impartial decisions or transactions.[118] Essentially, it comes down to whether a reasonable person would have done what the defendant did. In exceptional cases the courts will allow a case with no violation of fiduciary duty to go forward when it regards extreme risk-taking or misbehavior.

How does the plaintiff rebut the presumption that the directors acted in line with their duty of loyalty is not the same as evidence required to establish an infringement of the duty of care? That the director acts in good-faith assumption that the decision will be to the benefit of the company is a prerequisite for the duty of loyalty. So, when a director infringes his or her the duty of loyalty it is a subjective motivation. In contrast to a breach of the duty of care, which can be established by direct proof (evidence). When the courts establish an infringement of the duty of loyalty the court must ‘draw inferences about the director’s subjective motivation’ from relevant circumstances of the case and the ‘quality of the decision’ being challenged by the plaintiff. Thus the plaintiff must bring forward facts and circumstances on the basis of which the court can establish that ‘there is a reason to doubt’ that ‘the directors decision was based on a good-faith belief that it would’ be in the interest of the company. [119]

With regard to the Netherlands when a director has deliberately acted against the company, it is deemed that the director has acted with *‘opzet’* (intent). In Schwandt v. Berghuizer Papierfabriek,[120] it was held that the circumstances of the case, there were explicit limitations to the directors’ discretionary freedom breaching yet the director knowingly acted to the contrary, ‘revealed that the norms were supposed to protect the company from the director’s self-dealing’.[121] This damaging behavior is referred to as acting in (subjective) bad faith. Acting in (subjective) bad faith or self-dealing is substantially similar to breach of the duty of loyalty as it comes down to the same elements: to act in good faith and in the best interest of the company above their own personal interest. Data generated by legal-empirical study shows that cases where the judge is convinced of deliberate adverse behavior by the director no other factors seem to play a role in the final judgment; *‘opzet’* or self-dealing leads to personal liability. The latter also means that *décharge* by the company or other defenses have had no effect on the final assessment.

Décharge or waiver and limitation of liability can be granted to directors by the company in the company’s statutes, approval at the general shareholders meeting or by of the approval of the annual report.[122]

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[118] The Delaware Way: Deference to the Business Judgment of Directors who Act Loyally and Carefully, Delaware Corporate Law, Delaware.gov.
[119] Furlow, C.W., The Business Judgment Rule in Delaware, p. 1085, <https://heinonline-org.vu-nl.idm.oclc.org/HOL/Page?collection=journals&handle=hein.journals/utahlr2009&id=1093&men_tab=srchresults>.
[120] *Schwandt v. Berghuizer Papierfabriek*, Supreme Court, 29 November 2002, NJ 2003, 455. .
[121] Pham, N.T., Directors’ Liability, Wolters Kluwer 2017, p. 60, <https://www.navigator.nl/document/idc6b4444c19f247d8b203463b48f9b749?ctx=WKNL_CSL_2372>.
[122] Strik, D.A.M.H.W., *Grondslagen Bestuursaansprakelijkheid, Een Maatpak voor de Board Room*, Kluwer Deventer 2010, p. 168; Article 107 and 217 DCC.

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A *décharge* decision can be seen as a distance from legal claim towards directors, however the right to make a claim remains. On the other hand, an exoneration clause, i.e. a waiver, prevents liability form arising, i.e. that allocation of shortcomings to the director is excluded or limited. [123] Shareholders' approval of a *décharge* however does not stand in the way of directors being held liable by creditors. [124]

Thus waiver or limitation of certain directors' duties, even actions in bad faith is granted in the Netherlands to directors. However, in legal practice, the courts do not except *décharge* when it regards behavior of subjective bad faith, i.e. intentional adverse behavior (*'opzet'*).[125] The *décharge* does not extend beyond the annual financial statements. If the *décharge* is based on incorrect information provided by the director, f.e. when the director has deliberately withheld certain elements, then on the basis of the reasonableness and fairness principle and the *zorgvulidgheid* principle a director cannot rely or invoke the granted *décharge. In Staleman v. Van der Ven* it was held that the *décharge* does not extend to information or documentation that are not apparent from the annual accounts or not otherwise disclosed to the general meeting of shareholders before adopting the financial statements. Information available to an individual shareholder form other sources, outside the context of the general meeting of shareholders, or data that do not appear from the annual accounts or not otherwise made known to the general meeting of shareholders before the approval of the annual financial report are not covered by the *décharge.*[126]

Thus even though waiver or limitation of directors' duties are granted and accepted in the Netherlands, the courts have not accepted this defense when it regards intentional adverse behavior, i.e. subjective bad faith (*opzet*) or self-dealing. The qualification as self-dealing can only be evaded, similar to the duty of loyalty, when there has been explicit approval by the disinterested directors after being informed of the conflict of interest and the related material facts to the transaction and of the particular directors' relationship or interest are made known to them. However approval is very unlikely when it is not to the benefit of the company.

V.1. Analysis of Dutch Court Cases Between 2010 to 2018

In this research Dutch court cases between 2010 and 2018 will be analyzed to apply the business judgment rule, and more specifically the element of duty of loyalty to see whether these cases would have had a different outcome.

For purposes of answering the research question a sample of Dutch cases regarding directors' liability on the basis of Article 2:9 DCC are analyzed. The cases where identified by searching the keywords *'interne aansprakelijkheid van bestuurders ingevolge artikel 2:9 BW'*, which translates to 'directors' liability on the basis of Article 2:9 DCC'. This search was done on the database site, www.rechtspraak.nl, which

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[123] Spierings, C., *De eenzijdige rechtshandeling*, Wolters Kluwer 2016, p. 337.
[124] Strik, D.A.M.H.W., *Grondslagen Bestuursaansprakelijkheid, Een Maatpak voor de Board Room*, Kluwer Deventer 2010, p. 38.
[125] Idem, p. 122.
[126] *Staleman v. van der Ven*, HR 10-01-1997, NJ 1997, 360; Asser, C. and Maeijer, J.M.M., *Vertegenwoordiging en rechtspersoon: de naamloze en de besloten vennootschap,* Jjeenk Willink Deventer 2000.

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provided as a result 382 cases. This search result was further refined by decisions and publication date in the period from 2010 to 2018, which resulted in 297 decisions.

The 297 decisions were furthermore manually filtered to obtain relevant cases by selecting decisions by the Dutch Supreme, High and District Courts followed by a 'find-search' within the text of the judgment for '2:9 BW' and '*ernstig verwijt*' ('serious reproach') and by further manual exclusion of cases regarding:

- Public law cases (as not in civil law cases);
- Fiscal law cases;
- Cases including directors' liability, yet the legal analysis was not based on the legal grounds of this research;
- Intermediary decision (f.e. *Tussenbeschikkingen; interlocutoire uitspraken; comparitie van partijen; bewijsopdrachten; nemen van (nadere) conclusies of akten: uitlatingen*);
- Provisionary Court (*Voorzieningenrechter: f.e. Kort geding zaken; Ondernemingskamer zaken*).

The quantity of cases, after the above-mentioned selection criteria, amounts to 19 cases to be analyzed.

Table 1: Analyzed cases

	Cases	Court's decision		BJR outcome	
		Liable	Not liable	Liable	Not liable
1.	De Rouw v. Dingemans	X		X	
2.	BRR Participaties BV v. Broekmans Beheer BV		X	X	
3.	Fortis case	X		X	
4.	Cargill Financial Markets Plc and Citibank v. KPN BV e.o		X		X
5.	Stg. Derdengelden case	X		X	
6.	Landis Group a.o. case	X		X	
7.	Woningstichting Servatius		X		X
8.	Groen Invest Nederland		X	X	
9.	Ursus Utilities BV a.o	X		X	
10.	ACM Vastgoed BV case		X		X
11.	Foundation case		X	X	
12.	BV X case	X		X	
13.	Stad en Land Makelaars VOF case	X		X	
14.	Stadig case		X	X	

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15.	'Hybride Motoren' case	X		X	
16.	'De Schelfhorst BV' case,	X		X	
17.	'Shaw Almex Europe BV and SMC Industrial BV' case	X		X	
18.	Zowonen v. Domez BV a.o	X		X	
19.	Rotterdamse Bond van Volkstuinders v. Stg. De Beukhove a.o	X		X	

V.2. Sub-conclusion

With regard to the Netherlands when a director has deliberately acted against the company this damaging behavior is referred to as acting in (subjective) bad faith and or self-dealing.[127] Acting in (subjective) bad faith or self-dealing is substantially similar to breach of the duty of loyalty as it comes down to the same elements: to act in good faith and in the best interest of the company above their own personal interest. Data generated by legal-empirical study shows that cases where the judge is convinced of deliberate adverse behavior by the director no other factors seem to play a role in the final judgment; '*opzet*' or self-dealing leads to personal liability. The latter also means that *décharge* by the company or other defenses have had no effect on the final assessment. Which is also in line with the Delaware business judgment rule; pursuant to Delaware (US) the duty of loyalty cannot be waived or limited. Thus, even though waiver or limitation of directors' duties are granted and accepted in the Netherlands, the courts have not accepted this defense when it regards intentional adverse behavior, i.e. subjective bad faith (*opzet*) or self-dealing. In short acting in bad faith and or self-dealing constitutes improper performance of duties and thus is similar to the breach of the duty of loyalty as in the Delaware business judgment rule.

From the analysis of the cases between 2010 and 2018 regarding directors' internal liability it is evident that many cases do not make it to be reviewed in court, hence the 19 identified cases above. The reason for this is, as already established in this research, that the threshold of required proof regarding directors' liability in Dutch courts is higher compared to the threshold of required proof by the Delaware (US) and German business judgment rule. Because for the business judgment rule there is only a rebuttal required of the presumption that the directors have acted in compliance with their duties or the German business judgment rule where the burden of proof lays directly upon the directors Thus more cases would be admissible to the Dutch courts for review if the Delaware (US) business judgment rule would be applicable or if the threshold of proof in the Dutch procedure law would be adjusted to balance out the higher threshold of proof.

VI. Answering the Research Question

Table 2: Comparison US and Germany business judgment rule to the Dutch directors' liability standard.

[127] *Schwandt v. Berghuizer Papierfabriek*, Supreme Court, 29 November 2002, NJ 2003, 455.

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	Directors' liability	US	Germany	The Netherlands
1	Directors' duties	1. Duty of care 2. Duty of loyalty 3. Duty to act in good faith	1;2;3= similar a. Entrepreneurial decision b. Adequate info c. Company's interest d. Good faith e. No conflict of interest.	1;2;3=Similar • Duty to proper performance • Due care (*Zorgvuldigheid*) • Good faith and no self-dealing (*Redelijkheid & Billijkheid; Goede Trouw; opzet*)
2	Judicial review standard used by the court	BJR	BJR	Marginal review <=> Serious reproach standard + Reasonableness principle (*Redelijkheid en Billijkheid*) + Good faith (*zonder opzet*)
3.	Takes hindsight bias into account	Yes	Yes	Yes
4.	Burden of proof	Plaintiff must rebut the presumption	Director(s)	Plaintiff must satisfy a high threshold of proof compared to rebutting as is the case with US BJR or the German BJR where the burden of proof lays directly upon the directors

In Dutch procedure law there is a requirement for the plaintiff to substantiate (*substantiéringsplicht*) as much as possible his or her claim pursuant to article 111 (3) Dutch Procedure Code, besides the primary rule that upon the plaintiff rests the burden of proof of his or her claim if not motivating disputed by the defendant (*niet gemotiveerd betwist door gedaagde*) pursuant to article 150 Dutch Procedure Code. Thus, the

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threshold for the Dutch plaintiff is higher than with the business judgment rule. Also, because the business judgment rule starts as a shield or safe harbor for the decision/action(s) taken by the director(s) by placing the burden of proof on the plaintiff, but that is a lower burden of proof as only a rebuttal of the presumption is required.

The shield is the presumption that the directors "acted on an informed basis, in good faith ... that the action taken was in the best interest of the company [and its shareholders]."[128] However the burden of proof is just to allege facts sufficient to overcome that initial presumption,[129] i.e the rebuttal of the applicability of the business judgment rule presumption.

Once the plaintiff has successfully rebutted the presumption then the business judgment rule becomes a sword for the plaintiff, because now the burden of proof moves from the plaintiff to the directors; i.e. that the 'defendants [have] to prove to the trier of fact that the challenged' decision was fair in its entirety.[130]

Furthermore, the higher threshold of burden of proof in Dutch directors' liability procedure is affirmed by scholars, which works to the benefit of directors, but makes it only harder for the plaintiff to make a case against the director, especially in light of the accepted need for transparency after the last financial crisis.

That is why the Enterprise Chamber was effectuated in 1994, to help the parties get the information by having the Enterprise Chamber, an independent third party, investigate the administration of the company. However, the Enterprise Chamber does not grant damages for directors' liability so that the parties looking for regress still need to sue the director by bringing his claim to the regular court.

Assink and other scholars have argued that many corporate cases are not brought to the courts, but rather brought before the Enterprise Chamber due to its speedy process and specialized judges. Also, a lot of settlements (*schikking*) between parties are concluded to protect the company from public scrutiny.

The high threshold of burden of proof that resides with the plaintiff in Dutch Procedure law in comparison to if the business judgment rule would be applicable, being the Delaware or German version, infers a difference in the burden of proof resulting in the admissibility of a claim to be reviewed.

On the basis of the shift towards the Enterprise Chamber and the high threshold for plaintiffs wanting to challenge directors' decisions or hold directors' liable is perhaps why there were so little cases to analyze. As only the case with sufficient proof to meet the higher threshold of proof, than if the business judgment rule would be applicable.

Thus, the answer to the research question is that there would be a difference in outcome in Dutch liability if the Delaware business judgment rule would have been applied. This

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[128] *Emerald Partners v. Berlin* (Del.Supr. 2001); *Aronson v. Lewis* (Del. Supr. 1984).

[129] *Reget v. Paige* (2001 WI App 73).

[130] Welch, E.P., Saunders, R.S, Land, A.L., Voss, J.C., Turezyn, A.J., *Folk on the Delaware General Corporation Law: Fundamentals*, Wolters Kluwer Law & Business 2015, p. 164; *Emerald Partners v. Berlin* (Del. Supr. 2001); *Cinerama, Inc. v. Technicolor*, Inc. (Del. Supr. 1993).

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is affirmed in the analysis of the 19 cases. However when the case regards deliberate damaging behavior by the director, director acting in subjective bad faith or self-dealing, i.e. similar to a violation of the duty of loyalty (under the Delaware business judgment rule), once the case has met the evidence/higher threshold of proof it does not differ in outcome. Yet the difference remains in the threshold of proof that is needed for directors' liability. Thus, more cases would be admissible to the Dutch courts and subsequently reviewed if the Delaware (US) business judgment rule would be applicable or if the threshold of proof in the Dutch procedure law would be adjusted to balance out the higher threshold of proof.

As seen in table two the Dutch have substantively similar directors' duties: duty of care, loyalty & good faith.

To balance out the required higher threshold of proof in Dutch courts an adjustment would be needed in the Dutch Procedure Code to of course lower it. However, there is already a legal instrument used in Dutch (*bewijsrecht*) law of proof known as the *omkering van bewijslast*, that is the reversal of burden of proof. Pursuant to article 150 Dutch Procedure Code the party that is invoking the legal consequences of facts or rights it claims bears the burden of proof of those facts or rights, unless a different distribution of the burden of proof ensues from any special rule of from the requirements of reasonableness and fairness.[131] This requires exceptional cases. Without going in depth into this legal instrument an exceptional ground can be, to start with, the special responsibility that comes with companies of a certain magnitude and especially the special responsibility that rests upon the financial sector. It is widely accepted in law that with bigness comes a special responsibility, not only towards the company, shareholders or stakeholders, but also towards society as a whole.[132] Regarding the financial sector this special responsibility was also affirmed by the Dutch Supreme Court in the Fortis case.[133] The source of the recent global financial crisis is considered to originate in the financial sector. [134] Thus an adjustment of the Dutch Procedure Code would not be needed to accommodate liability claims against directors in the financial sector or large companies only new case law would need to be generated by the Dutch Courts, which would require a demand from society and the legal sector for this movement towards more transparency and accountability and so that inter alia the actions of those in charge can be reviewed if needed with a reversal of burden of proof. Because even long after the global financial crisis large companies are requiring bailouts from their governments or going bankrupt while they have the risk management protection system in place and yet fail. An example is the Royal Bank of Scotland[135] and the steel giant British Steel who is on the brink of bankruptcy.[136] The responsibility of directors of large companies or institutions is

[131] Google translation of Article 150 (Wetboek van Burgerlijke Rechtsvordering) Dutch Procedure Code.
[132] Nelemans, M.D.H., *Bestuurdersaansprakelijkheid in de financiële sector*, Paris B.V. Zutphen 2013, p. 62.
[133] *Ageas N.V. (former Fortis N.V.) v. VEB NCVB a.o.,* Supreme Court 6 December 2013, NJ1586.
[134] Khan, W., *Towards Context-Specific Directors' Duties and Enforcement Mechanisms in the Banking Sector*, Erasmus Law Review 2013, p. 93, 106.
[135] The Guardian, 22 May 2017, The RBS crisis: a timeline of events, From the bank's ill-fated 2007 takeover of ABN AMRO to the exit of Fred Goodwin and shareholders' £520m lawsuit; The Telegraph, 27 March 2018, RBS embarks on first takeover since ABN AMRO deal that broke the bank.
[136] De Telegraaf, 22 May 2019, Financial, Icoon British Steel in surseance.

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automatically greater, in particular in the financial sector, where banks cannot go bankrupt, also referred to as too big to fail.[137]

Of course, bona fide directors have nothing to fear as they would always act compliant to the procedural safeguards and thus, they would be free of liability. In performance of their duties the question to ask is: what would a reasonable thinking and performing director have done?

Lastly to answer the question of which business judgment rule, that of Delaware or that of Germany, would better suit the Netherlands, it can be concluded that both could benefit the Netherlands. Currently the Dutch liability procedure leans de facto towards the Delaware business judgment rule regarding cases of bad faith or self-dealing, with the exception to the required high threshold of proof.

As the German business judgment rule only differs from the Delaware business judgment rule regarding on whom the burden of proof rests upon (see Chapter III), that is upon the directors instead of in Delaware where it rests upon the plaintiff, but only regards a low threshold of proof, i.e. the rebuttal of the presumption. With a reversal of the required burden of proof as argued in this chapter the Dutch liability procedure would lean towards the German business judgment rule. Yet the reversal of burden of proof is just a proposal to balancing out the required high threshold of proof. The reversal of proof concept would however require further research of which this thesis can be considered the start of a series of research, perhaps a PhD-research subject. Given the research question of this thesis, the available time and recourses the current research is limited to the current research question.

VII. Conclusion

From the analyses of the cases in Chapter V regarding their outcome if the business judgment rule would have been applied it can be concluded that the threshold of proof is what would make the difference. As the elements of the business judgment rule are similarly applicable in the Netherlands as can be seen in table one in Chapter VI.

Even though the marginal review regards the burden of proof (*bewijslast*) and not the procedure law of burden of proof *(bewijsrecht*) pursuant to the business judgment rule, de facto this gives the same practical result as the presumption[138] of US the business judgment rule that the courts will only review the case when the contrary of the presumption is shown. Thus de facto both start with protection of the directors regarding the challenged action. However, in the case of the US business judgment rule the threshold of the required proof is lower (as only a rebuttal is required) than that which is required in the Dutch courts. Even though the Dutch do not refer to fiduciary duties there is an obligation to proper performance of duties (*behoorlijk bestuur*) and to act with *zorgvuldigheid, redelijkeheid & billijkheid* and *goede trouw*, which translates to act with care, as a reasonable person/director would with regard for good faith.

[137] Nelemans, M.D.H., *Bestuurdersaansprakelijkheid in de financiële sector*, Paris B.V. Zutphen 2013, p. 62.

[138] The presumption is that the courts will presume that the directors acted in compliance with their fiduciary duties and only will review the challenged action when the contrary is shown.

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The standard of review that is applied in directors' liability cases in the Netherlands is the standard of serious reproach (*ernstig verwijt*) in the meaning of article 2:9 DCC and case law *Stalemans/Van der Ven* a.o..

The burden of proof in the Netherlands regarding director's liability rests on the plaintiff pursuant to general procedure law. When this is weighed against the US/Delaware business judgment rule, a specific standard for directors' liability, where it can be used both as a shield (safe harbor or presumption) and a sword (only a rebuttal is required for the plaintiff in courts) and in case of the German business judgment rule where the directors carry the burden of proof that they acted according to their fiduciary duties. It can be concluded, and is generally known as well affirmed by scholars, that within the Netherlands the threshold for burden of proof for plaintiffs against the directors is quite high.

As was considered by the court in the Fortis case directors have a duty not only to the company and its shareholders, but also to stakeholders and in some cases due to the magnitude of its operations, especially companies in the financial sector, society as a whole has an interest in the results of its risk management.[139] It is generally accepted that large companies have a special responsibility and a general public interest, especially companies in finance and economics, given their magnitude of operations.[140]

As it is generally accepted that large companies have a special responsibility towards society as a whole I propose that the Netherlands make an exception to the general rule that the burden of proof rests upon the plaintiff suing a large company in the market which can be regarded to have a responsibility to society as a whole. By doing so the Netherlands would bring balance in the burden of proof now that most countries have a business judgment rule and shareholders derivative suit while this is not present in the Netherlands. Especially as in the globalized world doing business the shareholders or stakeholders are not all based in the same country and thus this will be to the benefit of the Netherlands corporate rating. Whether by lowering or bringing balance in the threshold of burden of proof requirement or by reversal of the burden of proof, for the plaintiff regarding large companies this would bring balance between the special responsibility of the large companies and the interest of the stakeholders when things go wrong to be able to hold those responsible actually accountable. I would propose to this especially in cases regarding subjective bad faith (*opzet)* of directors or self-dealing, i.e. the equivalent of violation of the duty of loyalty. Thus bona fide directors would have nothing to worry about for they can rely on the transparency of their decision-making process, especially regarding controversial decisions, by including independent experts reports or advise and other measures to illustrate the board of directors considered the alternatives.

Out of my research it can be concluded that directors are not aware of the way the Dutch courts review their liability and that is the cause for any fear or uncertainty on their part, while the courts application of the standard of serious reproach when assessing directors' liability and the decisions are quite consistent according to empirical data.

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[139] *Ageas N.V. (former Fortis N.V.) v. VEB NCVB a.o.,* HR 06 December 2013, ECLI:NL:HR:2013:1586.

[140] Nelemans, M.D.H., *Bestuurdersaansprakelijkheid in de financiële sector*, Paris B.V. Zutphen 2013, p. 62.

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I hope that with this research the discussion can be focused on where the real bottleneck exists and that is regarding the high threshold of burden of proof that rests on the plaintiff in Dutch (internal) liability cases. Thus a resolution could be a modification/accommodation in the procedure law when it regards large companies because of the special responsibility that comes with bigness.

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