DIRECTORS' LIABILITY
A LEGAL AND EMPIRICAL STUDY

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NAVIGATOR

Directors' liability
A legal and empirical study

Bestuurdersaansprakelijkheid
Een juridische en empirische studie

Thesis

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by

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Preface

On 10th March 2017, Thy Pham was awarded a Ph.D. by the Erasmus University Rotterdam for her study on 'Directors' liability. A legal and empirical study', supervised by Professor B.F. Assink, Professor L. Timmerman and Dr. T.F.C. Fischer.

Directors' liability is a popular theme in Dutch legal literature, although often missing empirical research. In her thesis Pham makes a valuable contribution to the literature by focussing on directors' liability as a system of sanction and protection for corporate governance. As a result, the thesis provides new legal and empirical insights in the behavioural dimension of directors' liability.

The chief merit of the dissertation is the connection between doctrine and practice. Pham employs multiple methods to reach her conclusions: case study conducted among 54 senior directors, legal and social literature study, qualitative and quantitative analysis of (case) law and legal comparative analysis (Delaware and Dutch company law). Three areas of research are distinguished: 1) defensive behaviour among company directors, 2) serious reproach as the analytical framework for reviewing directors' liability in the context of art. 2:9, 6:162 and 2:138/248 DCC, and 3) directors' 'good faith' as a basic condition for valid discharge claims.

Pham shows that directors' liability may be a concern for bona fide directors. In particular, directors facing bankruptcy and corporate fraud may perceive liability risks as real, threatening and a source of defensive behaviour. Taking into account that in 85% of the court cases which were analysed in the research involved a company's bankruptcy, directors' liability threat perceptions are not unjustified. Interestingly, Pham shows in the present study that bankruptcy was not statistically a significant factor for courts to assign or reject directors' liability. From a corporate governance perspective, Pham therefore argues that courts have an important role in providing clear communications about the circumstances in which a director does and does not incur liability.

Using 'serious reproach' as the analytical framework, an extensive study of case law resulted in a model indicating the most influential factors for courts to judge a director personally liable. A substantive part of cases under study ended with a court finding a director personally liable due to 'subjective bad faith' action. In cases *not* involving directors' 'subjective bad faith', Pham shows that the lens of judicial review focuses mainly on two factors which appear to be

influential and form a strong basis for judgement. They are: violations of norms specifically addressed to the director and meant to protect the company or the company's creditors and shareholders, and directors' foreseeability of damage to the company or the company's creditors or shareholders.

Combining comparative and empirical insights, Pham identifies poor corporate governance in the area of discharge from directors' liability. Empirical findings show that there was not one Dutch case under study in which a director was not held liable for acting in 'subjective bad faith'. This finding stands in stark contrast with existing doctrine, which suggests that a director may be discharged of personal liability for intentional harmful actions towards the company as long as these litigious actions were 'known actions' to a company's general shareholders' meeting. By analysing Delaware's case law on section 102 (b)(7) DGCL and comparing it with Dutch case law, Pham argues that it is poor corporate governance for a legal system to communicate ex-ante that its court will respect discharge resolutions shielding directors' actions in 'subjective bad faith'. Pham instead advocates to demand directors' 'subjective good faith' as a basic condition for good corporate governance.

This dissertation is multidimensional, thorough and innovative. It is written in an accessible style and contains strong analysis and arguments. It is our great pleasure to introduce this dissertation in the series of the Institute for Corporate Law.

M.J. Kroeze
J.B. Wezeman

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Chapter 1. A window on the research

1.1 The motivational basis of the research

Willemsen Beheer v. NOM came at a critical time in Dutch corporate governance. At the forefront of the current global financial crisis, the Dutch Supreme Court held in a directors' liability case that: 'it is in the best interest of the company that directors are prevented from undesirable defensive considerations when they discharge their obligations.'[1] Underlying this court decision is the assumption that taking risks is warranted to better the profitability and continuity of a company. If this claim holds true, stakeholders should favour governance mechanisms that allow bona fide directors to undertake risky projects and accept a high directors' liability threshold.

I have taken the Supreme Court's assumption in *Willemsen Beheer v. NOM* as the starting point of this research to study directors' liability as a corporate governance instrument, an instrument to control directors' behaviour. The disposition of directors' liability within the context of corporate governance allows me to view directors' liability as a cohesive system of sanction *and* protection against directors' liability risks. I was greatly inspired by some of the socio-legal works elucidating the various dimensions of law and legal sanction as well as several empirical works at the intersection of sanction and trust. Indeed, I have considered these works as important stepping stones to undertake a legal and empirical research on the topic of directors' liability as a system of sanction and protection.

1. Supreme Court, 20 June 2008, ECLI:NL:HR:2008:BC4959, par. 5.3 (*Willemsen Beheer v. NOM*). The same rationale of posing a high liability standard – serious reproach – to establish directors' liability as a means to avert undue risk-aversion to the detriment of the company's stakeholders was expressed in Supreme Court, 9 May 2014, ECLI:NL:HR:2014:2628, par. 3.5.2 (*Hezemans Air v. Van der Meer*) and Supreme Court, 5 September 2014, ECLI:HR:2014:262, par. 4.2 (*RCI Financial Services v. Kastrop*); ditto with respect to directors' liability in the event of bankruptcy as was expressed in the parliamentary history (House of Representatives of the States General 1983-1984, p. 4).

1.1.1 To punish and not to punish

The impact of directors' liability is often measured by its enforcement capability and the effects of legal sanction. While some legal scholars have argued the limited effects of legal sanction on directorial behaviour,[2] others in contrast, have emphasised the need for legal sanction to hold directors accountable for adherence to their duties. 'Would-be offenders may be responsive to the reputational sanctions of social censure, embarrassment, and shame that often flow from legal sanctions'.[3] Indeed, Fairfax rather challenges those who stay aloof of recognising directors' liability as a means to accomplish that goal.[4] Others contend trust to be pivotal in encouraging directors to serve the interests of their companies responsibly and faithfully. For instance, Blair & Stout argued that legal sanction disrupts trust and prevents directors from activating 'other regarding behaviour'.[5] Ripstein discussed how legal sanction may decrease trust because it introduces grounds for distrust.[6] However, distrusting a director is preferred over mistrusting a director.[7] Legal sanction may reassure a potential trustor that it is relatively safe to trust and that even in the worst case scenario, he or she will not suffer intolerable high damage.[8]

In an experiment, Fehr & List[9] examined how Chief Executive Officers (CEO's) respond to the threat of sanction in situations requiring trust and trustworthiness. Interestingly, their research showed that the CEO's in the study responded in a less trustworthy manner if faced with an explicit threat of punishment. Trustworthiness was shown to be lowest if the threat of sanction was implemented. However, the availability of the sanction threat generated hidden returns: when an actor refrained from the sanction threat, the other person displayed a more trustworthy behaviour than in a situation in which there was no threat at all. Strikingly, trustworthiness was shown to be highest if the threat of sanction was available but not implemented.

The above-mentioned research results provide important insights. I have drawn the following lessons for my own research. First, it is pivotal to understand how directors *perceive* directors' liability risks and director protective shields to understand their potential responses to threats of personal liability. Second, the latent potential of legal sanction and the deliberate non-use of legal sanction seem to be of significance to reduce the possibility of opportunistic behaviour

2. Eisenberg 1999; Spier 2011, p. 14.
3. Baker & Griffith 2010.
4. Fairfax 2005, p. 393-456.
5. Blair & Stout 2001, p. 1735-1810. See also Sitkin & Roth 1993, p. 367-392.
6. Ribstein 2001, p. 553-590.
7. O'Neill 2002, p. 70.
8. Luhmann 1979, p. 36.
9. Fehr & List 2002.

on the part of a director. I have appreciated these research findings in their suggestion that directors' liability legislation, in its potential as a corporate governance instrument, should involve sufficient threat perception on the part of directors while allowing them to reduce excessive risks of litigation; the latter being equally critical to prevent directors from shirking their responsibilities out of fear of being sanctioned.

Defensive behaviour

I have interpreted the experiment and research finding of Fehr & Liszt as suggesting that one of the alternatives to control opportunistic behaviour may lie in the latent functioning of legal sanction – the availability of legal sanction and the non-use of it. The latent function of legal sanction may however be more accurately understood if directors' perceptions of and attitudes towards directors' liability risks are taken into consideration rather than the likelihood that those hazards will harm them. Accordingly, Chapter 2 is devoted to the study of defensive behaviour in relation to directors' personal liability threat perceptions and involves four main research issues. First, directors' perceptions of liability risks, second, directors' fear of liability risks and potential response with defensive behaviour, third, the (un)problematic nature of defensive behaviour, and fourth, directors' evaluation of director liability shields.

1.1.2 Recognising the dimensions of directors' liability legislation

Directors have a distinct position of authority involving power that occurs in institutionalised form.[10] Directors exercise of power rests in legal arrangements – collectively binding arrangements – which constrain opportunistic behaviour.[11] Directors' liability functions as a keystone within the institutionalised arrangement. Perhaps the most conventional concept of directors' liability is its potential to constrain and regularise behaviour. Sociologists have characterised this type of control as involving regulative control of behaviour.[12] In the attempt to influence directors' behaviour, directors' liability would involve specific rules which can monitor whether they were complied with, and can be enforced with sanctions. In a regulative understanding of directors' liability in which conformity to rules is emphasised, enforcing sanctions against deviant behaviour is pivotal.[13]

10. Gerven (1983, p.8) speaks of 'hierarchs' conferred with decision-making power which allows them to govern over interests that go beyond self-interest; Slagter & Assink (2013, p. 920-921).
11. Lane & Bachmann 1997, p. 226-254.
12. Scott 1995, p. 35; Beale & Dugdale 1975, p. 45-60.
13. Scott 1995, p. 50.

Director duties are typically open-ended, however. Timmerman has argued that director duties involve discretionary decision-making and cannot be 'regularised' or seized in specific rules.[14] Furthermore, Assink has argued that directors may be seen as role performers.[15] Their conduct is *ipso facto* susceptible to enforcement. Directors may face legal sanction by reason of failure to perform their role in its specific context, not merely because the director concerned had not complied with specific rules.[16] Accordingly, directors' liability legislation may not be accurately viewed as solely regulative and coercive, but may also be considered as involving normative and cognitive attributes.

The assumption described above may find empirical support. In a Cambridge study, over sixty firms in the mining machinery and kitchen furniture industries operating in Germany, Britain and Italy were randomly selected. Lengthy interviews were conducted to understand the institutional characteristics of the different business systems. The researchers found that norms and sanctions may have important normative and cognitive value in the sense that they may afford individuals reliable frameworks of appropriate behaviour on which to base their interactions with one another without having to overly resort to self-protection. The research revealed the informative source of legal norms and their ability to create shared knowledge about expected behaviour and their effectiveness to foster trust.[17]

I have regarded the Cambridge research as providing important insights for understanding the potential of directors' liability to control directors' behaviour. First, it is important to recognise the various dimensions of directors' liability in providing stable patterns of generally accepted behaviour. Directors' liability may exert control by prescribing norms of what directors are 'supposed to do', or should 'avoid doing' given their designated role and authority (also termed normative control).[18] In addition, directors' liability may involve frames describing routines, scripts, or 'ways in which things are or should be done' that would make sense in a given situation. Such common frames are informative and allow directors to relate specific behaviours to specific situations (also termed cognitive control).[19] Second, if normative and cognitive control are deemed important attributes of directors' liability, judges play a significant role

14. Timmerman 1992.
15. Assink (2010, p.1) emphasised the important function of company law to reduce complexity by prescribing expectations of directors' role performance.
16. See also Berger & Luckmann 1966, p. 74.
17. The research resulted in several papers, among others Arrighetti, Bachmann & Deakin 1997; Burchell & Wilkinson 1997; Deakin & Wilkinson 1998, p. 146-172.
18. Scott 1995, p. 38.
19. Zucker 1988, p. 23-52; Lord & Kernan 1987, p. 265-277; March & Olson 1989, p. 23 (March and Olson apply a broad concept of norms including guidelines, standards, routines, best practices and programmes).

in contributing to and communicating stable patterns of behaviour which are either beneficial, wasteful, or damaging, and should be avoided. As directors' liability is primarily shaped in case law, courts play an influential role in controlling directors by articulating acceptable and non-acceptable courses of action. Third, if courts are able to provide powerful structures explicating expectations of directors' responsibilities and liabilities in their respective roles in given situations, there may be less need for undue self-protection; of those exerting decision-making power and of those who make themselves vulnerable to directorial discretion.[20] In the end, the best protection a director may have, might be transparency and predictability in possible courses of action to stay aloof of liability risks.

The threshold of 'serious reproach'

Informing individuals about common understandings of directorial responsibilities and liabilities may reduce complexity and increase predictability. One way to do this may be to clearly communicate a threshold. Such a threshold may specify problematic and intolerable behaviour on the part of a director and direct orientation towards explicit consideration of legal sanction.[21] The liability standard of 'serious reproach' [ernstig verwijt] may embody such a threshold. Chapter 3 is therefore devoted to establishing the importance of courts in reducing uncertainty as regards the factors determining directors' personal liability. More specifically, I focused on studying case law involving directors' liability litigation qualitatively and quantitatively to discover the most significant factors for Dutch courts to hold a director personally liable and determined the consistency and predictability in legal decision-making.

1.1.3 The importance of legal sanction

In the Netherlands, the framework of directors' liability is based highly on trust in directors. First, boards of directors are trusted with the ultimate responsibility to manage or direct the management of the business and affairs of their companies. In managing and directing the company's business, they are trusted to

20. See also Zucker (1986, p. 54-111) who has argued that trust between social actors is more likely to occur where reliable norms of behaviour makes future behaviours more predictable than in situations where these rules do not exist or demonstrate deficiencies.
21. Luhmann 1979, p. 74 (the important function of centralizing sanction has been argued to break the circle of increasing distrust to turn into 'unmanageable cases. Sanction and distrust can be seen as internal controls of a legal system and prevents that a system may be immediately destroyed when trust is breached).

govern over the company's interests, which goes beyond self-interest.[22] Second, in the exercise of decision-making power and in balancing the interests of the company and its stakeholders, it is a prerogative that decisions made are not second-guessed by judges. As a principal, discretion is recognised and substantive judicial review is replaced with marginal judicial review.[23] Trust manifests in the belief that undertaking an enterprise requires a degree of autonomy of action: to act with prejudice to some stakeholders, or to the benefit of other stakeholders in a given situation, to take high risks and make erroneous decisions, sometimes with detrimental consequences. As long as these actions are within the boundaries of their discretion and involve due care considerations, directors are given the benefit of the doubt.[24] Hence, directorial discretion and marginal review may be assumed to imply trust in directors. This raises the question of how legal sanction relates to trust.

In an empirical research involving a study among employees in several European countries, Weibel et al. explored whether formal control was positively or negatively related to employees' trust in the organisation.[25] The researchers did not find evidence for the hypothesis that control was negatively related to trust. Interestingly, they did find that all forms of organisational control, output, behaviour control and sanctions, were significantly positively related to employees' assessment of the trust they have in their organisation.[26] Lack of control, having double standards and not sanctioning deceitful behaviours were seen to result in organisational untrustworthiness.[27] The research revealed how formal sanction was a central theme for the respondents. Respondents indicated that companies that fail to sanction deceitful behaviour or condone such behaviours, create significant problems across a business ('a cycle of deviant behaviour'). These findings were suggested to imply a 'sequence for organisational trust, with the behaviour of directors setting the scene for other employees and other groups.'[28]

I have regarded the above-mentioned research findings of considerable importance. It can be argued that in the context of directors' liability, actively implementing legal sanction may in certain situations be of great significance.

22. Barber (1983) has also termed these responsibilities as involving fiduciary responsibilities. Although in the Netherlands the legal concept of fiduciary does not exist, directorial authority assumes trust in directors in the sense that directors are charged with acting and representing the interests of the company (Timmerman 2004, p. 11-12; Slagter & Assink 2013, p. 920-921; Dijk & van der Ploeg, 2007, par. 8.6.1 indicating a trust relationship between a director and the foundation).
23. See for a critical discussion on marginal judicial review Assink & Kroeze 2010, p. 11-32.
24. Timmerman 1992.
25. Weibel 2009.
26. Weibel et al. 2009, p. 26.
27. Weibel et al. 2009, p. 25.
28. Weibel et al. 2009, p. 26.

Directors' liability may not prevent directors from wrongdoing. It may, however, ascertain that if discovered and identified, these directors do not go scot-free. As was suggested by Weibel et al. implementing legal sanction against such directors may foster trust in business. Moreover, it may foster trust in the legal system as trust may not merely be placed in individual directors but in the functional elements of the legal system.[29]

Discharge from directors' liability

The suggestions made by Weibel et al. stand in stark contrast with the existing Dutch legal doctrine on discharge [décharge] from directors' liability for acts carried out in bad faith. Where their research findings indicate that directors' good faith is important to foster trust in and across businesses, standing case law in the Netherlands shows that a valid discharge granted by a company's general shareholders' meeting may shield directors from liability claims arising from serious reproachable conduct, including intentional harmful conduct, under the condition that the general shareholders' meeting was knowledgeable of the litigious action which can be traced from the company's annual accounts or other information provided to them.[30] Chapter 4 is therefore devoted to the study of the Dutch discharge in the light of good corporate governance and involves an exploration of directors' good faith as the baseline for courts to allow a discharge resolution to have legal effect.

1.2 What this book is (not) about

Traditionally, directors' liability legislation has been argued to serve two main functions: allocation of damage and control of behaviour.[31] The first function involves the question of who (the director or the injured party) will pay (for what part of) the damage.[32] Or more broadly, who will bear the financial risks of directors' actions – the director, the company, third parties of the company or insurers, in full or part?[33] Indisputably, this is an important question with lots of money involved. However, it was not the driver of this book. The driver

29. Luhmann 1979, p. 22 (identifying trust that extends beyond personal trust as involving system trust). See also Maas-de Waal, Dekker & Van der Meer 2004, p. 17-23 (distinguishing interpersonal and institutionalised trust).
30. Dutch Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1 (*Staleman v. Van de Ven*); Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308, par. 3.2 (*Ellem v. De Bruin*); Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 4.2 (*De Rouw v. Dingemans*).
31. Baker & Griffith 2010 p. 6 (distinguishing two independent rationales, compensation and deterrence); Kroeze 2004, p. 226-233. See also Slagter & Assink 2013, p. 1003 (distinguishing between the function of allocating damages and influencing behaviour).
32. Van Schilfgaarde 1988, p. 264.
33. Baker & Griffith (2010, p. 6-8) speak of 'pocket shifting'.

of this book is the second function of directors' liability legislation, the control of directors' behaviour. In studying the potential of directors' liability legislation to control directors' behaviour, I went beyond the traditional legal view of directors' liability as predominantly regulative and coercive. This allowed me to understand directors' liability as an intricate system of sanction and protection and to consider the explicit and latent characteristics of directors' liability. The motivational basis of this book was discussed in paragraph 1.1.

I have mentioned that I have divided my research into three blocks. This book therefore consists of three pieces of research. Each piece of research is devoted to a specific research issue and can be read separately (Chapters 2, 3 and 4). Although I discuss the underlying research methodology in each of the chapters, it is important to note here that this book is in large a product of legal and empirical research. This has the important implication that while I studied positive law, legal doctrines and legal literature, and recognised the virtues that apply to traditional legal research, they were not the primer on which I based my findings nor the main method through which I reached my conclusions and propositions. Law in action and qualitative and quantitative empirical legal methods have provided me with important resources. Specifically, directors' perceptions and attitudes towards directors' liability risks (prevalent in Chapter 2) and the courts' perceptions and assumptions as represented in court decisions involving directors' liability litigation (prevalent in Chapters 3 and 4).

1.3 Structure

The perspective of this research lies in understanding directors' liability as a system of sanction and protection with regard to its addressee – the director. In the realm of Dutch company law, claimants are required to satisfy a high liability threshold to hold a director personally liable.

I have started the research from the assumption that bona fide directors should not fear directors' liability risks and resort to unnecessary defensive or protective measures. In the first part of the research it was found that bona fide directors may exaggerate the consequences of directors' liability risks and may respond defensively when faced with potential liability risks due to uncertainty as regards the norms that judges, ex-post, may apply when assessing directors' courses of action (Chapter 2).

In the second part of the research, I took the uncertainty of judicial decision-making as the point of departure and analysed case law qualitatively and quantitatively. The concept of 'subjective bad faith' was used to distinguish

'unproblematic' cases in which courts seem likely to adjudicate a director personally liable from more 'complex' cases involving uncertainty as regards courts' judgement. It was found that in the 'complex' cases (cases *not* involving directors' 'subjective bad faith'), courts nonetheless reached judgement fairly consistently. Moreover, it seems that only a few compelling legal case factors exhibited significant predictive value with regard to judgments involving a director's personal liability. Where a court, in a 'complex' case found that a director could be made a serious reproach and judged the director concerned personally liable, I have interpreted the director's action as conduct 'lacking good faith'. Where a court, in a 'complex' case had refused to hold a director personally liable, I have interpreted the director's conduct as involving 'good faith' (Chapter 3).

The third and final part of the research was focused on exploring court cases involving directors' 'bad faith' in connection with discharge provisions. In these specific court cases, directors have invoked the protection of a discharge in an attempt to shield their personal liability of 'bad faith' actions. In analysing these cases, I have distinguished directors' actions involving 'subjective bad faith' from those involving 'lack of good faith' in order to discover whether the difference in serious reproachable conduct may play a role in the outcome of a specific court case. The result of this research indicated that this was not the case. It was found that courts were unwilling to allow discharge provisions to cover 'bad faith' actions, regardless of the type of serious reproachable conduct. Where doctrine and empirical finding stand in contrast, I argued there should be a critical debate on the existing concept of discharge. Moreover, looking critically at the data, it was possible to distinguish between directors' 'subjective good faith' and 'objective good faith' as regard discharge. Directors' actions performed in 'objective good faith' do not amount in serious reproachable conduct. Therefore discharge was effectively not a problematic issue in these cases. Directors' actions performed in 'subjective good faith' may however be qualified a serious reproach. Discharge then also may raise legal debate. As an alternative to the existing doctrine, I finally suggested on the basis of *Ellem Beheer v. De Bruin* and *De Rouw v. Dingemans,*[34] that directors' 'subjective good faith' should be the baseline to review discharge claims. On the whole, whatever the legal motivation of the scope of discharge may be, this research brings the empirical insight that only bona fide directors are freed of personal liability (Chapter 4).

The research closes by providing reflections on how the research findings relate to some existing debates and developments in the domain of directors' liability (Chapter 5).

34. Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*); Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).

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Chapter 2. Defensive behaviour as good corporate governance? *A case study*

2.1 Introduction

This Chapter focuses on the defensive behaviour of company directors. Its primary object is to explore the relationship between the perceived threat of directors' liability and defensive behaviour. The study is largely based on 54 interviews with senior directors of major Dutch group companies, supplemented by 10 interviews with legal professionals, insurers and risk managers.[1]

The assumption is that fear of directors' liability curtails risk taking. If true, apprehension about directors' liability may give rise to corporate governance problems, as risk aversion may become one of the overriding factors motivating directors, compelling them to perform their tasks in ways that reduce the chance of incurring personal liability. This study focuses on four main issues: (1) the ways in which directors perceive liability risks, (2) the aversion that directors have to such risks and the defensive behaviour that may result, (3) the point at which such defensive behaviour may become problematic, and (4) the values that directors attribute to director liability protection.

In response to these research issues, an exploration of the conditions that may fuel the apprehensions of directors about their liability and trigger their defensive behaviour. This will be followed by an assessment of the function that director liability protection serves or may serve in reducing the concerns that directors have with regard to their liability. Finally, it will be suggested that the fear of public proceedings is not the root problem underlying defensive behaviour but the fact that directors are rather uncomfortable with uncertainty. Directors are not only uncertain about actual liability risks, but they are also unfamiliar with standards of liability. This realisation suggests that courts may have an important role to play in aligning perceived and actual liability risks and may enhance good corporate governance by clearly articulating when and why a company director is relieved of liability or may be held liable.[2]

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1. In this research, a senior director may be an executive or non-executive director representing the senior level of corporate governance in a group company incorporated under Dutch law. See also paragraph 2.3.3.1 for more details on the target group of research and Appendix I of this Chapter for the characteristics of the target group of research.
2. Parts of this research has been published (Pham 2014; 2015).

This research was conducted in the period 2012-2013.

2.2 Literature review

2.2.1 Directors' liability as a corporate governance instrument

Directors' liability is believed to be an important corporate governance instrument that provides incentives for or imposes constraints on the behaviour of company directors. Two important views may be argued regarding directors' liability in this respect. According to the first view, directors' liability has a deterrent function. The threat of liability induces company directors to take due care and to avoid risky decisions that may jeopardise the company's continuity. The second view shifts directors' liability to the background. Risk taking is seen as a prerequisite for the survival and continuity of a company. Recognising the 'primacy' of risk, makes it necessary for company directors who undertake risky projects to be protected under the framework of directors' liability legislation.[3]

The focus of this Chapter is on this second view, one in which the Dutch case *Willemsen Beheer v. NOM* plays a central role.[4] In the judgment, it was assumed that the fear of personal liability may prevent company directors from undertaking risky projects that could potentially benefit the company. The Supreme Court decided that it was in a company's best interest to have directors' liability legislation mitigate such undesirable forms of risk aversion. This study explores the 'defensive behaviour argument' in more detail. To link this court decision to defensive behaviour and to understand how defensive behaviour might result in a corporate governance problem, I intend to make an analogy with the situation in medicine by borrowing from the literature available in studies on defensive medicine and risk perception.

It has long been recognised that personal liability may cause Dutch company directors to be extra careful in their actions, since they might have to bear for any injurious conduct.[5] This flies in the face of the fact that, in the Netherlands, litigation is relatively infrequent[6] and the probability of out-of-pocket settlements relatively low.[7] This low frequency of out-of-pocket payments may

3. Rosenberg 2009, p. 221.
4. Supreme Court, 20 June 2008, ECLI:NL:HR:2008:BC4959 (*Willemsen Beheer v. NOM*).
5. Baker & Griffith 2012, p. 9; Fairfax 2005, p. 434-456.
6. Blankenburg 1998, p. 1-41 and Blankenburg 1994, p. 789-808. Moreover, I studied a sample of Dutch court cases involving directors' liability claims (2003-2013) and found a weak increase in decsions finding directors liable (see Chapter 3, Figure 2).
7. In the present study, 1 out of 54 participants reported having agreed to out-of-pocket settlements. The payment involved attorney's fees, which were partly reimbursed by the company. For a comparative view, see Black et al. 2005, p. 153-171.

indicate that most cases are not litigated but settled within D&O policy limits and that directors are consequently insulated from the costs of legal action. As a result, these costs have little impact on the directors' decision-making and exercise of due care. Nevertheless, empirical research indicates that the perceived probability and severity of punishment are influential in changing an individual's mode of behaviour.[8] Despite the low frequency of a company director being held personally liable and the rarity of out-of-pocket settlements, several surveys indicate that the risk apprehensions of directors do not correlate well with their actual liability risks. Some scholars have suggested that company directors respond to a perceived chance of incurring liability with defensive practices, greater precautions or avoidance of risky activities altogether.[9] This position is supported by surveys indicating that the threat of directors' liability and unfavourable legal decisions have a significant impact on a director's willingness to accept board appointments.[10] Such surveys may generally provide support for the deterrence theory by emphasising the role that an individual's perception of legal sanction plays in the propagation of defensive practices among company directors. They do not, however, tell us anything about the manner in which and the conditions under which looming liability comes to be perceived by a company director as a serious personal threat.

Specific empirical studies on the relationship of perceived liability and risk taking are largely confined to the medical profession[11] and have not been extended to cover issues relating to directors' liability. Like a physician, a company director is considered a professional who is exposed to personal liability in exercising his or her profession and must abide by the profession's standards of care. Liability may arise for both of these professionals if a breach of care is demonstrated and this breach results in harm. This study therefore brings new insights in the understanding of defensive director behaviour by placing the focus on a director's liability and desire to limit it.

8. Block et al. 1981, p. 429-445; Hollinger & Clark 1983, p. 398-418; Klepper & Nagin 1989, p. 209-240; Paternoster & Simpson 1996, p. 549-584; Pogarsky 2004, p. 343-369.
9. Herzel et al. 1987, p. 38-43; Kaplan & Harrison 1993, p. 412-432; Kroeze 2005.
10. *AABD survey results. Measuring bank directors' fear of personal liability*, The American Association of Bank Directors 2014; Corporate Board Member Europe/ PriceWaterhouseCoopers, 'Board Insights 2004: What Europe's Board Directors Think', *Corporate Board Member magazine* 2004, available at http://www.pwc.com/en_US/us/corporate-governance/assets/cbm_wdtsupp05.pdf; M. Lückerath-Rovers & A. de Bos, *Nationaal commissarissen onderzoek 2012,* Nyenrode Business Universiteit, Erasmus Universiteit Rotterdam 2012, available at www.nyenrode.nl/ncgi/onderzoek.
11. Burns et al. 1999, p. 134-146; Carrier et al. 2013, p. 1383-1391; Carrier et al., 2010, p. 1585-1592; Dranove & Watanabe 2012, p. 69-94; Kessler & McClellan, 1998; Lawthers et al. 1992, p. 463-482.

2.2.2 *Defensive behaviour*

In the context of company law, the literature on directors' defensive behaviour is often affected by hindsight bias. Judgments about a director's course of action may become unfairly biased once courts are informed about the negative outcome of a business decision. The key emphasis in the literature falls on the fact that company directors prefer to minimise risks when confronted by the fear of being held personally liable because courts are likely to judge business decisions ex-post on the basis of their negative effects.[12] The obvious conclusion is that legal judgments in hindsight thus cause company directors to take excessive precautions in foresight.

Moreover, there is a greater tendency for the courts to be subject to hindsight bias when cases are determined on the basis of an objective standard of reasonableness.[13] When deciding on the liability of a company director, Dutch courts apply a substantive, marginal judicial assessment of the director's course of action and require the director to make decisions, on balance, within the range of reasonableness that would be expected from an ordinarily prudent businessman or woman.[14] In each of the individual cases brought under the court's review, assessment involves a 'multi-factor' analysis of the circumstances against the background of the open-textured formulation of 'serious reproach' (also known as the *Staleman v. Van de Ven* 'all circumstances' doctrine).[15] The case-by-case method of reviewing a director's conduct strongly emphasises individualised context-specific factors and, it can be argued, is important for reaching fair results. Nevertheless, the literature suggests that, as the Dutch courts are bound to a marginal substantive assessment, they are more likely to be susceptible to hindsight bias and more vulnerable to judicial errors.[16]

Given this risk of bias, Dutch law typically ensures that businessmen and women are protected against the potential negative effects of this bias.[17] In other words, the Dutch legal system deals with such bias by tolerating it while requiring that the threshold of 'serious reproach' be met before directors' liability may

12. Rachlinsky 1998, p. 591.
13. Rachlinsky 1998, p. 591; Kamin & Rachlinski 1995, p. 99; LaBine & LaBine 1996, p. 506.
14. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*).
15. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*).
16. Assink & Kroeze 2010, p. 11-32.
17. Compare Arkes & Schipani 1994, p. 613; Rachlinsky 2000, p. 72.

be assumed.[18] Although hindsight bias has a very high profile in the legal literature on company law, it should be recognised that studies on hindsight bias and legal culpability are primarily concerned with understanding and reducing erroneous judicial decisions. Little attention is paid, however, to the ways in which company directors perceive risks and respond to them. Whether company directors fear liability and respond to it with defensive practices is an empirical question that has generally been overlooked in the literature. At the same time, director fears about incurring personal liability serve an important function in Dutch company law, compelling the legal and business community to implement measures to protect directors from personal liability. In the present study, I take directors' perceptions and attitudes about the risks of liability as the point of departure and demonstrate that the defensive behaviour argument is used by courts and the business community to motivate efforts to equip directors with director liability protection. Within the focus of this study, I understand director liability protection to include the liability standard of 'serious reproach' developed in Dutch case law, statutory liability defences (exculpation) and contractual clauses, including Directors' and Officers' Liability insurance (D&O insurance), indemnification and exoneration.

2.2.2.1 Defensive behaviour in Dutch case law

The impact of court decisions (finding or not finding directors liable) on a director's willingness to undertake risky projects is an important issue. Director propensity for risk taking was first recognised and protected in the landmark case *Willemsen* Beheer v. NOM. The Supreme Court decision in this case assumes that any stakeholder with an interest in the future profitability and continuity of a company would want the company to take risks.[19] Stakeholders should therefore rationally accept a high level of liability protection and demand that there be governance mechanisms in place that allow directors to undertake risky projects. The Supreme Court reasoned that it would be in the best interests of a company to prevent the occurrence of defensive practices: 'It is in the best interest of the

18. It is interesting to compare how Delaware courts cope with the problem of hindsight bias by providing immunity from liability. Delaware's *business judgment rule* has effectively proved to be a 'no liability' rule that instructs courts to refuse to hold company directors liable if they made an informed decision, had no personal interest in the decision, and the decision was rational in the light of the company's interest. The result is that company directors are protected from liability for negligent business decisions. Some Dutch authors have argued that such a 'no liability rule' may not only reduce the impact of hindsight bias, but may also promote risk taking (Assink, 2008a, p. 230-236; Assink 2008b, p. 356-358; Assink 2007, p. 540-579; Kroeze 2005, p. 18).
19. Supreme Court, 20 June 2008, ECLI:NL:HR:2008:BC4959 (*Willemsen Beheer v. NOM*).

company that company directors are prevented from undesirable defensive considerations [out of fear of directors' liability, TP] when they discharge their obligations.'[20]

The defensive behaviour argument utilised in *Willemsen Beheer v. NOM* is arguably based on three sequentially-linked assumptions: (i) the threat of directors' liability influences the behaviour of directors; (ii) the threat motivates directors to engage in undesirable defensive behaviour; and (iii) the undesirable defensive behaviour has negative effects.[21]

2.2.2.2 Defensive behaviour in business

Director liability protection is an integral part of corporate governance. Firstly, it helps to recruit men and women for responsible positions on the company's board of directors. Of the directors interviewed in this study, not a single one of them did not have D&O insurance. Provision of such insurance was a precondition for accepting board service. Several directors argued that they would not be able to do their job properly without knowing that they were well protected. Many of the directors interviewed (75%) demanded both D&O insurance and indemnification, referring to these kind of protection as 'belt and braces'. Secondly, director liability protection is seen as part of the company's risk and insurance management. Directors' and officers' insurance is considered a common good, which can be attained at relatively low cost. Therefore, the absence of D&O insurance is considered to be a signal that a company may not be managed properly or is in trouble, and therefore should be viewed with suspicion. Thirdly, there is a common understanding in the Dutch business community that, in general, it is good corporate governance for companies to relieve directors of liability by providing either indemnification or D&O coverage or both.[22] In all of the examined cases, indemnification clauses were drafted in such a way

20. Supreme Court, 20 June 2008, ECLI:NL:HR:2008:BC4959, par. 5.3 (*Willemsen Beheer v. NOM*). The same rationality of posing a high liability standard – serious reproach – to establish directors' liability as a means to avert undue risk-aversion to the detriment of the company's stakeholders was expressed in Supreme Court, 9 May 2014, ECLI:NL:HR:2014:2628, par. 3.5.2 (*Hezemans Air v. Van der Meer*) and Supreme Court, 5 September 2014, ECLI:HR:2014:262, par. 4.2 (*RCI Financial Services v. Kastrop*); ditto with respect to directors' liability in the event of bankruptcy as was expressed in the parliamentary history (House of Representatives of the States General 1983-1984, p. 4).
21. These assumptions will be challenged by the research findings in paragraph 2.4.
22. About one-third of the examined 83 large (listed) Dutch companies (based on the definition of art. 2:397 and 2:142a DCC) provide indemnification in their articles of association (note that I only inspected the articles of association of the Dutch group companies and their Dutch subsidiaries that are part of this study). Analysing the companies' articles of association revealed that the companies' subsidiaries articles of association did not include indemnification provisions.

that there would be no further entitlement to compensation for the costs or financial losses that a company director may have incurred if they were covered by insurance, and the insurer had paid the costs or compensated for the financial loss. Only one participant in the research additionally attained an individual insurance policy, separate from the company.

2.2.2.3 Understanding defensive behaviour better

There is a rich body of empirical research in defensive medicine that focuses on the relationship of liability to defensive behaviour. There is a consensus that physicians amend their behaviour to reduce malpractice liability, ranging from assurance behaviour to avoidance behaviour with regard to medical treatments and practices.[23] Several empirical studies demonstrate that it is the perceived rather than the actual liability risk that motivates physicians' defensive behaviour.[24] These studies show that physicians associate lawsuits with a feeling of dread and distress. Lawsuits are regarded as unpredictable and uncontrollable events with disastrous consequences both personally and financially. The impact of these consequences are said to produce a statistically irrational level of risk aversion. Liability risks have therefore been classified as 'dread risks' (risks that are so strongly associated with negative effects that their low probability is neglected ('probability neglect') in order to express the overestimation of these risks.[25] The abovementioned studies thus suggest that the defensive attitude of physicians has little rational basis, given the actual liability risks. Not only does the excessive defensiveness lead to rising health care costs, it also stimulates negligent behaviour among physicians when the urge to minimise personal liability risks prevails over the need to provide effective and adequate health care or even access to healthcare for patients.[26]

2.3 The research

2.3.1 Research questions

The view that individuals tend to overestimate liability risks has gained ground among legal scholars. It is argued that it is undesirable that company directors avoid risky but potentially profitable decisions because they have become an increasingly attractive target for legal claims. It is likewise undesirable that

23. Studdert et al. 2005, p. 2609-2617.
24. Burns et al. 1999; Carrier et al. 2013; Dranove & Watanabe 2010; Kessler & McClellan 1998; Lawthers et al. 1992.
25. Carrier et al. 2010, p. 1591; Carrier et al. 2013, p. 1389; Sunstein (2003, p. 121-136) used the term 'probability neglect'.
26. E.g. Tancredi & Barondess 1978, p. 879-882.

company directors are preoccupied with calculating the risks of a claim because they assume that they can expect its assertion even if they act prudently and in good faith.[27] In both cases, company interests are in danger of not being served in the best possible manner because directors fear exposure to liability risks. For the purposes of this research, I understand the defensive behaviour of directors as:

> Behaviour that occurs when company directors (1) take unnecessary precautions and/ or (2) neglect their duty of care, primarily, but not exclusively, to limit personal liability risks.[28]

I designate the first behavioural pattern as assurance behaviour. This may include implementing elaborate internal controls, keeping more extensive records of board meetings and board decisions, ordering more information and administrating extensive risk analyses prior to business decisions in order to appear to meet the legal responsibilities placed on directors. The second behavioural pattern may be referred to as avoidance behaviour. A director then isolates him- or herself from possible sources of directors' liability by, for example, not attending board meetings or taking part in board discussions, avoiding emergency and crisis situations, adhering only to low-risk activities, refusing to take high-risk decisions, or even refusing board service in high-risk industries.

My understanding of defensive behaviour thus implies that concerns for personal liability may induce company directors to neglect their duty of care because of their desire for assurance and/or avoidance. Moreover, this desire may, in fact, be based on perceived rather than actual risks, as it is rather the perception that leads directors to overestimate directors' liability risks. Insights from cognitive psychology reveal that individuals persistently make decision errors which prevent information being accurately assessed when calculating the risks associated with appropriate due care behaviour. Even when individuals believe that they are making considered decisions, these decisions may be based on general tendencies rather than on calculation of the risks of legal sanction.[29] These tendencies may include judgments based on similar situations or based on

27. Kroeze (2005) identified defensive strategies among Dutch company directors, ranging from the use of external advisory services and reports merely to underpin decisions that have already been taken, to supervisory directors dismissing executive officers in order to mitigate their own liability risks.
28. This definition is based on the definition provided by Sclar & Housman (2003, 75-84) on defensive behaviour among physicians.
29. Shuman 1993, p. 163.

previous knowledge or experience.[30] As such, individuals are likely to underestimate liability risks and behave in an unsafe, offensive, or harmful manner, or they may overestimate liability risks and avoid desirable activity due to their perceptions of liability risks that may differ significantly from the reality.

Both the courts and the business community have developed director liability protection in order to limit the assumed negative effects of defensive behaviour caused by directors being overly preoccupied with personal liability. No empirical research has yet been carried out on the question of whether and under what conditions directors display an irrational fear of liability risk and consequently engage in undesirable defensive behaviour, or the extent to which liability protection may mitigate such a tendency to adopt defensive behaviour. In this research, I will attempt to explore such issues. The research questions are formulated as follows:

1. How do directors perceive directors' liability risks?
2. What conditions may instigate liability risk aversion and defensive behaviour among directors?
3. To what extent may defensive behaviour be problematic?
4. What values do directors attribute to director liability protection?

2.3.2 Research method

In this research, I will endeavour to understand the perceptions that directors have of liability risks and how they may respond to it. Moreover, I will examine how directors perceive the functions of liability protection and the potential value of such protection.[31] Given the target group – senior directors of major (listed) Dutch group companies – and the sensitivity of the research topic,[32] I did not expect to be able to observe these directors throughout their daily routines. Moreover, I also expected to face difficulties regarding their willingness to participate in the research, should it demand too much of their time. I preferred to interview a relatively large number of directors instead of focussing on a small number of participants in the study.

30. Tversky & Kahneman 1982.
31. I did not intend to test the potential causal relationship between liability and defensive behaviour and whether the relationship may be mediated by liability protection. Instead, I wished to describe and understand directors' perceptions and attitudes about directors' liability risks (see also Parker & Lehmann Nielsen (2011), who make distinctions between objective and perceptual research approaches to the understanding of regulatory compliance).
32. In paragraph 2.3.3.1, I assumed that the specific target group is the one most aware of directors' liability risks.

I further combined interviews with other sources of information and methods of data collection[33] to overcome the limitations of each of the individual methods.[34] At the time of the interviews, the participants represented at least 83 listed companies relevant to this study.[35] I studied publicly available corporate documents for each of the companies, analysed media reports on these companies and the participants, and evaluated court decisions. Finally, these sources of information were complemented, compared and validated with interviews with legal professionals, insurers and risk managers.

2.3.3 Data collection

2.3.3.1 Interviews

I interviewed 54 senior directors,[36] of those interviews 53 were conducted in person and one, due to distance and time, by telephone. In one interview, the director requested that the company's legal counsel be present during the interview, to which I consented.

The 54 participants represent the senior level of corporate governance in a number of major (listed) group companies incorporated in the Netherlands: 24 held executive positions and 30 were supervisory board members. These were conceived main positions. Many of the participants in addition occupied board positions at multiple companies.[37] The target group was selected on the assumption that the directors of group companies are strongly aware of directors' liability risks, as they bear the final responsibility for any liability risk within the group company.

The first ten key participants were randomly selected. To gain access to other directors and to solicit wider participation, existing networks were explored. At the time of their interviews, all of the participants were directors under the articles of association and subject to Dutch statutory directors' liability legislation.

The interviews varied in length from one hour to two hours and were held from May to September 2013. To guide discussions, I used a topic list which I did not distribute beforehand.[38] The topic list targeted directorss perceptions in four

33. See paragraph 2.3.3.2-2.3.3.6.
34. See, for example, Bijleveld (2007, p. 89), who discussed the importance of triangulation in relation to the internal validity of research.
35. See also paragraph 2.3.3.3.
36. I approached 62 senior directors in total.
37. See also paragraph 2.3.3.3.
38. Note that the interviews are characterised open interviews. The topic list was set up thematically and can be found in Appendix II.

research areas of interest: the perception of probability and impact of directors' liability risks, the conditions under which directors' liability is perceived to be threatening and may be a source of defensive behaviour, the extent to which defensive behaviour is perceived to be problematic, and the expected value of director liability protection in reducing defensive behaviour. All interviews were transcribed.

With the help of a coding scheme, I analysed the interviews using Microsoft Excel. The coding scheme involved the issues in the topic list mentioned above and enabled me to structure my analysis thematically. I followed up the analysis by studying the structured data from different perspectives.[39] For instance, the frequency of observations was counted in order to have an overview of such factors as the number of participants confronted with directors' liability litigation. In a much more extensive and deliberate process, I analysed the data by describing and construing the factors underlying directors' perceptions of liability risks, the impact of their attitudes about these risks, as well as the actual effects of the risks themselves.

It is important to note that all participants consented to be interviewed on the condition that the conversations would not be tape-recorded and that the results were not traceable to the director or the company concerned. Several participants did not wish to be quoted. I complied with all such requests and, in general, limited my use of quotations. References for any quotations from these interviews that appear in this study only contain the number of the participant and the participant's position.

Hereafter, I will use the term company director to refer generally to a member of the senior management of the group companies, including both executive and non-executive directors, unless otherwise specified. The term non-executive director shall refer to supervisory directors in a two-tier board system and external directors in a one-tier board system.

2.3.3.2 Analysing corporate documents

The second method in this study involves analysing corporate documents. Primarily, such analysis concerns the company's annual reports, corporate governance reports and other governance related documents, including rules of procedure of the executive and supervisory boards, resignation and reappointment schedules, remuneration policy, codes of conduct, any whistle-blower procedure, as well as the companies' articles of association. I used the most recent versions of these documents which were publicly available and downloadable

39. Boeije 2005.

from the corporate website. To be certain that financial statements and articles of association were the most recent ones, my search included the database of the Dutch Chamber of Commerce. Most of the financial statements were dated 2012. Finally, I compared the companies' press releases with news reports in the free press (see paragraph 2.3.3.4).

2.3.3.3 Participants and company characteristics

Of the 54 participants in the case study, 49 were male and 5 were female (Appendix I, Figure 1). The majority of the participants were aged 50 years or older (Appendix I, Figure 2). They had a wide range of professional experience in terms of company type and industry (Appendix I, Figures 3 and 4). Appendix I, Figure 4 shows their experience in listed and complex organisations. It must be noted that all of the non-executives except for one were previously executive directors. All of the participants had cross-border experience. Regarding their individual experience with liability, 18.5% of the 54 participants reported having been subject to liability litigation, including a closed suit, one that was dropped, settled, and/or paid out. Of the 54 participants in the study, 11.1% reported that they instigated a directors' liability suit or threatened to do so against former directors (Appendix I, Figure 5).

The participants represented 83 listed companies relevant to this study and held 125 positions within these companies.[40] This means that the participants occupied more than one position in the companies investigated. In terms of professional designation, within the group of 83 companies, 11% of the participants held a CEO position, 8% a CFO position, and 29% held the position of board chair (Appendix I, Figure 6). The focus of the study was on the larger (listed) companies. The gross revenue of the companies under study ranged from €49 M to €51,300 M. The majority of the companies under study had gross revenue of between €500 M and €1,000 M (Appendix I, Figure 7).[41]

2.3.3.4 Analysing media reports

The third method of data collection involved the analysis of Dutch media reports from the free press relating to each company and participant. I searched the LexisNexis database for media reports from 2003 to the date of the last interview in 2013. I also consulted Management Scope, a Dutch business magazine that publishes interviews with directors, articles on business strategies and governance issues and searched each of the participants on www.managementscope.

40. The 83 companies are the large listed companies in the meaning of art. 2:387 DCC.
41. The data on the company gross revenue was collected from the company annual reports of 2012.

nl. In addition, I searched on www.veb.nl and followed all of the VEB actions that might be relevant to the interviews and were publicly available. The VEB is the Dutch investors' association.

2.3.3.5 Analysing court decisions

The fourth method involved analysing court decisions. Some of the participants had faced directors' liability litigation either as defendant or as claimant representing the company.[42] I analysed these court decisions and compared them to the interviews and used them to validate the information obtained. For instance, it was extremely important for the participants who had been defendants in proceedings that a court had 'acquitted' them of liability. For the participant who had acted as a claimant, it was important that a court had condemned the directors in question of acting with malicious intent, which had been the main reason that the participant had initiated legal action against the (subsidiary) directors.

2.3.3.6 Interviewing legal counsels, insurers and risks advisors

The fifth method of data collection involved 10 additional interviews with legal professionals, insurers and risk managers. I spoke with 2 legal counsels, 1 company secretary, 3 company lawyers, 2 insurers and 2 risk managers. These interviews served to reflect on and to validate the findings I obtained from the interviews with the directors.

Moreover, I assumed that these professionals are an important source of information for directors when assessing their liability risks. For instance, the legal professionals with whom I spoke had regularly attended board meetings or had formal and informal contact with some of the directors involved in this research. Their observations enabled me to review my findings on the directors' perceptions of liability risks. For instance, I was told that the directors they advised were interested and eager to be informed about directors' liability risks and about how certain business decisions could entail personal liability risks. Moreover, the legal counsels with whom I spoke felt it was their responsibility to provide directors with 'state of the art' protection in order to facilitate 'good corporate governance'. Furthermore, I was told by one of the legal counsels that his legal team was keen to update their board of directors with new case law material on liability risks. Indeed, three of the directors who I interviewed, could spontaneously cite sentences from several court decisions.

42. See Appendix 1, Figure 5.

The insurers told me that claims were increasing and were being filed more promptly. These observations suggest an increase of litigiousness. Unfortunately, the insurers had no statistics to support their statements. The risk managers described the D&O insurance market as a 'soft market': 'there is overcapacity'. Premiums are relatively low. Powerful companies are in the privileged position to extend their coverage and increase the sum that they wish to insure against low costs. It was their belief that many of the larger companies had done just that. Unfortunately, there were no accompanying statistics to provide evidence for this view.

2.4 Findings

2.4.1 Do senior directors fear directors' liability risks?

> *'If you know how some directors are being treated, it's not an extreme feeling to be on guard. The climate in the Netherlands is incredibly governed by populism, to the detriment of the person concerned and the company. To suppliers, to customers and to the people working for the company. I'm being constantly warned to watch out… lawyers, banks, supervisors, works council. They [a group of investors, TP] threatened me, to sue me.'*[43]

It has long been assumed that emotions have a significant impact on how individuals perceive risks and act on them.[44] Several empirical studies on risk and feelings show that feelings of fear influence an individuals' perception and tolerance of risk. Feelings such as dread, stress and anxiety have proven to have an impact on an individual's risk assessment and decision-making, which is also known as the 'affect heuristic' in literature.[45]

I found that the affect heuristic was also important in terms of how the directors under study perceived directors' liability risks. Directors' liability was strongly associated with a feeling of dread. It was described as unpredictable and uncontrollable and one of the most stressful and traumatic experiences.[46] One important finding in my study is that a director's perception of his or her liability risks is not just rational but also involves an affective element. This may cause

43. Participant 4, CFO.
44. The general assumption of this research is that individuals often fall prey to *biases* which prevent them from accurately calculating risks. Fischhoff et al. (1978, p. 127-152) introduced the psychometric paradigm to address the question of why people perceive a variety of hazards differently. The researchers found that dread was a major factor in risk perception.
45. Slovic & Peters 2006; Slovic et al. 2005; Slovic et al. 2000, p. 397-420.
46. Similar findings were found among physicians regarding malpractice claims (Charles et al. 1987, p. 462-466, 468; Charles 1991, p. 22-26; Martin et al. 1991, p. 1300-1304; Palacio 2008, p. 1032-1034).

divergence between *perceived* and *actual* liability risks. The majority of the directors tended to overestimate directors' liability risks.[47] Because the consequences of directors' liability were exaggerated, the probability of their occurrence received little consideration.[48] The interviews revealed the extent to which directors' liability risks carry affective meaning and are strongly associated with negative outcomes, while disregarding risk level and the statistical probability of incurring actual liability. Directors of major companies may fear directors' liability risks despite such risks being not well-founded, because their consequence may nevertheless be devastating.

2.4.2 When do senior directors resort to defensive practices?

The research results indicate that certain circumstances may cause directors to perceive directors' liability as a serious threat and reason for engaging in defensive behaviour. These situations arise when a director is intensively exposed to public opinion and/or when litigation seems likely. Cases of fraud or bankruptcy were frequently mentioned as justification for defensive behaviour. Past difficulties with regard to directors' liability also provoked concerns about future liability. Moreover, the research reveals that the public and personal consequences of a liability claim may have a far greater impact on a director than the financial consequences, as the latter are generally deemed to be avoidable by means of insurance. Consider the following:

> *'Shareholders can easily threaten to damage your reputation. If you incur reputational damage, no one will hire you in the future. Financial risks are manageable and you have to manage them. If I tell my wife that I don't mind to assume the financial risks. No way. Then I may as well quit everything I'm doing. You can't cover reputational risks, but you can insure financial risks.'*[49]

2.4.2.1 Fraud

> *'I don't feel that our supervisory board or executive board, including myself, are driven by liability risks. Yes, there's a thin line between being careful and covering your asses. If there's fraud and, in particular, with*

47. It must be noted that two CEO's in the study who, at the time of the interviews were the company's owners, (co)founders or controlling shareholders tended to underestimate liability risks. They described a feeling of immunity to liability and a strong belief that liability risks can be prevented by 'demonstrating good faith and honesty' and by acting on 'best knowledge'.
48. Loewenstein et al. (2001) found that people are very sensitive to high positive or negative consequences, regardless of their probability.
49. Participant 42, supervisory director (chair).

> *involvement of third parties, there's an immediate stepping up. Your concerns go up two levels. I think it's important to understand what this could mean for me, personally. I want to know everything about it. I don't see it as counter-productive. And I want to be covered for the entire spectrum. The company can expect that I'm doing my utmost best.'*[50]

Allegations relating to fraud were perceived to be personally threatening because of the high level of unknown risks in terms of the extent and severity of the financial and reputational damage to the company and the director concerned. Fraud exposure was often associated with a failure of managerial control and inadequate internal controls at subsidiaries. When fraud is suspected, there is consequently an immediate concern that parent company directors may not have been as 'in control' as they should have been and may be vulnerable to directors' liability.

Several developments may potentially amplify a director's sense of personal liability for corporate irregularities. For example, several participants mentioned the obligation to provide a whistle-blower scheme as part of the internal control framework and the corresponding duty to act on detection of irregularities.[51] Moreover, group company directors are more attentive to the control measures at subsidiaries because they have to account for the group shortcomings regarding internal controls in annual reports.[52] A second factor is that non-executive directors are keener to initiate internal or forensic investigations with or without the co-operation of the executive board. Many of the supervisory directors who were interviewed felt it was one of their important duties to act in response to signs of irregularity, whether of a general, operational or financial nature, but especially if these irregularities involved executive board members. A third issue relates to liability exposure due to international anti-bribery legislation as well as the books-and-records provisions under the US Foreign Corrupt Practices Act 1998 (FCPA). The FCPA imposes American anti-bribery laws on all (i.e. both US and non-US) listed and unlisted companies and natural persons, as well as accounting practices on listed companies.[53] Consequently, the FCPA acts as an international standard on the basis of which the business integrity, books and records of companies are monitored worldwide. A small

50. Participant 38, CEO.
51. Compare Best practice II.1.7 DCGC 2008.
52. Compare Best practice II.1.4 DCGC 2008
53. See 15 U.S.C §§ 78m(b)(2)(A) (imposes liability for corrupt practices); see 15 U.S.C §§ 78m(b)(2)(B) (imposes strict corporate liability on issuers for books-and-records violations and failures of adequate systems of internal control at subsidiaries).

sample of important cases involving Dutch companies has made directors even more aware of the ways in which the anti-bribery and books-and-records provisions have increased potential personal liability exposure.[54]

2.4.2.2 Bankruptcy

> *'We tried to save the joint! We didn't think of our liabilities. The idea creeps in when you get to the point that you have to report to the tax authorities that you're actually bankrupt. The bad thing is that it triggers the actual bankruptcy. The bank will ask questions. And then you say to the bank, things are well. And then things get worse.'*[55]

Bankruptcy was perceived to be personally threatening, as research participants strongly believed that a bankruptcy trustee will likely lodge a claim in most cases, or at least threaten to do so. The participants felt that they were easy targets for bankruptcy trustees and, as such, subject to 'selective liability' practices, irrespective of whether they were to blame. Bankruptcy trustees have been criticised for deviating from their own professional standards and being motivated by their own or their firms' financial interests rather than the interests of the bankruptcy estate.[56]

Moreover, the fear of a claim was reinforced by the availability of D&O insurance and the prospect that recovery or settlement is secured. There was a general feeling that the accessibility of D&O insurance increased directors' vulnerability to threats of litigation, as the participants felt that others perceive them as having 'deep pockets'. Therefore, many of the participants assumed that the higher the D&O limit, the more likely it would entice bankruptcy trustees, creditors or the company to press for settlement or litigation.

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54. *In the Matter of Royal Dutch Petroleum Company and The 'Shell' Transport Trading Co., p.l.c.* (SEC Exchange Act of 1934 Release No. 50233, Accounting and Auditing Enforcement Release No. 2085, and Administrative Proceeding File No. 3-11595 (all dated August 24, 2004); *Securities and Exchange Commission v. Koninklijke Ahold N.V.* (Royal Ahold), Civil Action No. 04-1742 (RMU) (D.D.C.) (October 13, 2004); *Securities and Exchange Commission v. A. Michiel Meurs and Cees van der Hoeven*, Civil Action No. 04-1743 (RMU) (D.D.C.) (October 13, 2004); *Securities and Exchange Commission v. Johannes Gerhardus Andreae*, Civil Action No. 04-1741 (RMU) (D.D.C.) (October 13, 2004); *In the Matter of Koninklijke Philips Electronics N.V.* (SEC Exchange Act of 1934 Release No. 69327, Accounting and Auditing Enforcement Release No. 3452, and Administrative Proceeding File No. 3-15265 (all dated April 5, 2013).
55. Participant 52, supervisory director (chair).
56. According to the Guidelines for Bankruptcy Trustees (*Isolad Praktijkregels voor curatoren*, par. 22), the trustee in bankruptcy is obliged to first examine whether there are grounds that give rise to make claims against former directors for personal liability in connection with bankruptcy. See also Kalff 2007.

2.4.2.3 Individual experience

> *'The whole thing ended with "acquittal" by the Supreme Court. That's major! If you experienced something like that, you become more alert. I try not to be guided by the consequences of the risks. I believe that I understand what I'm doing, how certain processes run by making the effort that they're running in the right direction. I always make sure that I'm well insured. I also want to see the insurance policy and check it myself.'*[57]

Adoption of defensive behaviour may depend on individual experience with directors' liability, which might either amplify or reduce risk perception and trigger a defensive response.[58] The directors in this study who were previously exposed to directors' liability were clearly more concerned about their personal liability exposure than their peers were. Unlike some of the company directors who had no previous liability experience, none of the directors with this experience were prepared to serve on boards without D&O insurance cover *and* indemnification. Previous research has, in contrast, suggested that individual exposure to risk may increase habituation and minimise risk awareness.[59]

In this research I found that repeated risk experience could result in reduced risk attentiveness only under specific conditions. These include circumstances when litigation is dropped (e.g. when claims are ill-founded) or when the impact is low and the outcome neutral (e.g. when financial and personal consequences are marginal).[60] The interviews notably revealed how directors may recover from repeated risk exposure if a claim is dismissed, even though the exposure may have large financial and personal consequences. Dismissal of a personal liability claim was associated by the participants with the recognition of one's personal and professional integrity, and was seen as an important step in the rehabilitation process in which reputation is restored and psychological trauma overcome.[61]

This may explain why company directors attach such great importance to legal defence and compensation for legal expenses. The interviews showed that the company directors who were repeatedly exposed to directors' liability claims and able to defend themselves successfully, were clearly less concerned about the impact of litigation on their career and their reputation than those who had settled a case or whose cases were pending. Furthermore, these successful defendants displayed considerable knowledge of directors' liability legislation and less concern for future directors' liability exposure. They expressed confidence that directors' liability risks could be controlled, managed, and overcome.

57. Participant 2, supervisory director.
58. Barnett & Breakwell 2001, p. 175.
59. Richardson et al. 1987, p. 16-36.
60. Barnett & Breakwell 2001, p. 176.
61. See similar results in the context of medical malpractice: Martin et al. 1991, p. 1303.

2.4.3 Is defensive behaviour problematic?

> '*I don't see being cautious as being problematic. Sometimes it's good to be conservative. Caution turns into risk aversion if you don't want to run any risk or want to exclude all risks. I know some supervisory directors who are like that and they are also the subject of complaints on the board.*'[62]

The participants and the legal professionals with whom I spoke commonly acknowledged that defensive behaviour may result in increased wasteful overhead expenses and, in the worst case, threaten a company's competitiveness by excessively avoiding or excluding risks and steering the company into recession. Although it is difficult to know where reasonable caution ends and defensive behaviour begins, it can nevertheless be argued that defensive behaviour may become undesirable and have a negative effect when company directors are inclined to exclude all risks under an absolute avoidance credo or an unreasonable assurance requirement. In such cases, directors neglect their duty of care by isolating themselves and disregarding a necessity to act.[63] Both types of defensive behaviour may lead the company into recession and compromise its continuity, ultimately having potential personal consequences.

Nevertheless, risk reduction and risk avoidance are generally considered appropriate concerns of the prudent business operator. MacCrimmon & Wehrung demonstrate how decisions are frequently made on the basis of risk adjustments and, when such adjustments cannot be made, risk avoidance, without always considering the best option among a set of alternatives.[64] Risk adjustment practices included collecting additional information and in-depth studies, delaying decisions to allow new factors to come to light or spreading responsibility for losses by insuring certain risks. Other strategies to adjust risks involved delegating risky decisions, sharing risks to obscure individual accountability (e.g. decision-making by a joint board or decision by committee) or decentralising decision-making in the attempt to allow someone else in the organisation to assume responsibility. The ability to adjust and avoid risks at both the business and personal levels may, arguably, correlate to a director's adaptability in creating more favourable situations in which risks can be taken and overcome.

62. Participant 41, supervisory director (chair).
63. See also paragraph 2.3.1.
64. MacCrimmon & Wehrung 1986, p. 174-175.

2.4.4 Does director liability protection reduce the tendency to behave defensively?

> *'Look, I don't think people come to work thinking "how's my liability". I feel we all are doing our very best for the company. They [liability shields, TP] are part of doing business. If you knew how many claims arrive in this office... am I to assume all of them? I don't think so. I get that I can be held personally accountable, that I get, but there must be a degree of accountability that is justified.'*[65]

Dutch company directors can be held personally liable for harm to the company and to third parties. Both sources of directors' liability may be reduced contractually. In the first case, an exoneration clause may waive the company's right to sue its director for possible future losses arising from a breach of director duties. In the second case, an indemnification clause may serve to shift possible future losses arising from third-party claims to the company. Companies will likely then mitigate these risks by immediately transferring them to a D&O insurer. Moreover, statutory law provides liability limitation, and Dutch courts have developed a liability standard that functions to shield directors from liability.

The question now is how this liability protection influences attitudes held by directors concerning personal liability risks. The interviews revealed that liability protection has an important function, as it allows company directors to reduce the magnitude of their exposure to liability risks, at least to a tolerable level. The probability of liability is, however, difficult to adjust. In the following paragraphs, the various legal instruments provided by the Dutch legal system are discussed in terms of their effectiveness in mitigating defensive behaviour.

2.4.4.1 Exoneration

Two forms of exoneration are provided by the Dutch legal system: statutory exoneration (exculpation under the law) and contractual exoneration (discharge and exculpation by contractual agreement). The latter type of exoneration involves a decision of the company's general shareholders' meeting. At the core, exoneration is intended to exclude the liability of an individual director, with the caveat that the various forms of exoneration may vary in their scope of protection.[66] To escape liability, an individual director may invoke

65. Participant 20, CFO.
66. In the current legal literature, Assink & Olden (2005, p. 13-14) offer the most far-reaching perspective on the scope of contractual protection.

statutory exoneration.[67] Regardless of the grounds for the claimant's liability claim, an individual director may successfully respond to it by demonstrating that no improper management or negligence in taking measures is attributable to him or her.

The value of a contractual exoneration depends on whether a participant in the study perceived it as a corporate governance instrument, an element in a potential legal defence or an immunity provision. In general, the directors in this study perceived contractual exonerations as corporate governance instruments. Exculpation provisions may attract candidates to board positions on companies in high risk industries. They may be a means to enable a temporary appointment of a supervisory director to the executive board in order to replace a departing member. They may also provide comfort to those candidates who are required to act promptly in the face of a company's potential insolvency. At the same time, a majority of the participants also associated exculpation with 'immunity' and 'poor corporate governance' since it relinquishes an important remedy enabling the company to recover damages caused by its directors. The majority of the directors interviewed seem to generally believe in the deterrent function of directors' liability, causing a director's action to remain in alignment with company interests, or at least to circumvent deviations from a company's key interests. Some of the directors indicated that they had used the threat of legal sanction to discipline subsidiary directors or former directors, or exposed subsidiary directors or former directors to liability risks by withholding discharge. These participants could not imagine themselves asking for or providing exoneration as a means to limit directors' liability risks. Asking for exculpation was therefore associated with 'asking for problems'.

In contrast, discharge was more widely perceived as a corporate governance instrument, 'control mechanism', than as legal immunity. Generally, the decision to provide discharge is taken by and 'under the control' of the annual shareholders' meeting. As part of each year-end closing, shareholders base their discharge decision on the director's past performance. Interestingly, since a discharge provision was perceived as providing verily limited protection, the participants in this study generally considered discharge as 'good corporate governance'.[68] Some of the participants in this research however have personally experienced that, under conflicting circumstances, the benefit of a discharge may not outweigh the costs. A general shareholders' meeting that refuses

67. Underlying art. 2:9 DCC (liability to the company) and art. 2:138/248 DCC (liability in bankruptcy) is the collective responsibility of the board, resulting in the joint-and-several liability of the board, with the possibility of individual exculpation as stipulated in art. 2:9 (2) DCC and 2:138/248(3) DCC.
68. In Chapter 4, I will demonstrate, based on a sample of court cases (2003-2013), that a discharge decision only covers directors when acting in good faith.

discharge may inflict severe reputational damage on a director. As one interviewee noted: *'Everyone wants to be discharged. It means that you've done your work well. If more than 35% of the shareholders decide to the contrary, I believe I should reconsider my activities. People will also see you as a loser.'*[69]

The directors interviewed were also very realistic about the value of discharge and exculpation. There was a common understanding that discharge or exculpation does not reduce exposure to liability risks. To put it differently, legal immunity was recognised as an illusion: the company's civil law options remain untouched. I was told that, even if a discharge was explicitly granted to a director, the proof of the pudding is in the eating. As some of the participants recalled, '*a discharge provides only psychological reassurance, nothing more.*'[70]

Any legal effect of contractual exonerations may only be established in court proceedings as part of a director's defence. Accordingly, regardless of whether discharge or exculpation is understood as a corporate governance instrument, legal immunity or a director's best defence, the question remains whether it may prevent company directors from acting defensively, as the threat of litigation remains intact. Moreover, if directors fear the prospect of a court trial, there is no indication that statutory or contractual exonerations may reduce defensive behaviour, since interference by the court will be necessary in order to activate any legal protection that they might provide.

2.4.4.2 Directors' and Officers' Liability insurance and indemnification

> *'If a company doesn't provide adequate D&O insurance and indemnification coverage, I cannot be their supervisory director. There are lots of things I can't control or things that may happen beyond my fault, but for which I can be held liable. D&O and indemnification are like hygiene. It's normal that these things are in place. I explicitly asked* [name company, TP] *to give me D&O and indemnification coverage. I want both: belt and braces. People have asked me why I'm doing it, going on board. There are 30,000 people working there…30,000. And if I think I can help this company not go pop, I want to do it. But I do believe that it shouldn't affect my risk.'*[71]

Indemnification and D&O insurance seem to be considered institutionalised instruments of director liability protection. All of the 83 companies that I examined in this research have transferred directors' liability risks to a third

69. Participant 4, CFO.
70. Participant 18, supervisory director.
71. Participant 34, supervisory director (chair).

party, a D&O insurer. About one-third of the companies provided both indemnification and D&O coverage. Companies that provide indemnification will not do so without having taken out D&O insurance. The participants in the research considered D&O insurance to be like any other company insurance, such as property or fire insurance, and simply part of the company's ordinary business insurance plan. Moreover, D&O insurance and indemnification are tightly linked in the sense that, when indemnification is provided, D&O coverage is seen as part of the company's obligation to reimburse company directors for damages based on the indemnification provision as established in the company's articles of association.

The participants used two major important arguments to justify indemnification. The first is that some D&O insurers do not cover damages that company directors may incur as a consequence of personal fines imposed by regulatory authorities. The participants considered such fines to be inherent to the risks attached to the position of a company director.[72] Nevertheless, it has long been the prevailing opinion under Dutch contract law that insurance contracts should not cover any such fines imposed for reasons of public policy.[73] Companies have overcome this problem by providing indemnification applying to the damages resulting from fines. As I was informed by the legal counsels who I interviewed, the companies for which they work typically agree to indemnify directors until an individual director is adjudged liable for conduct qualified as 'serious reproach', wilful misconduct or deliberate recklessness. As one cannot determine beforehand when norms have been violated, companies take the stand that, pending the outcome of a case, there is continued entitlement to reimbursement.

The second argument relates to the liability limits of D&O insurance. D&O policies are subject to a maximum monetary amount payable under the policy for loss resulting from claims first made during the policy period. Under an A/B/C D&O policy, the aggregate limit of liability usually applies to all claims first made in a single policy year, and constitutes a combined limit of liability for both direct coverage and company reimbursement coverage. Directors are concerned that several different types of proceedings (multiple claims) may be brought against several different groups of insured persons (company directors,

72. See also A. Hendrikse 2011.
73. There is controversy about the coverage of damage caused by gross negligence. The Dutch Insurance Code stipulates in art. 7:952 DCC that damage caused by wilful misconduct or gross negligence is not covered. Nevertheless, D&O insurance contracts may deviate from this provision as art. 7:952 DCC is not a mandatory provision of Dutch law. I was informed by the risk managers whom I interviewed that insurers generally do deviate. Generally, insurers will only exclude directors' actions displaying evident bad faith.

employees, and the company) at the same time (multiple insured persons). As a consequence, the D&O coverage may be exhausted to the extent that individual directors run the risk of incurring out-of-pocket expenses. It was argued in the interviews that, should the D&O coverage be exhausted or the D&O insurer insolvent, a second line of protection must be available: the company's indemnification coverage.

The interviews revealed important positive side-effects attached to such forms of protection against directors' liability. If the threat of a court trial is a potential instigator of defensive action, then the liability protection may be effective in reducing this behaviour. It seems that such protection provides psychological comfort, being perceived to reduce uncertainty. The instruments adjust liability risks in the sense that a certain loss – in terms of an insurance premium – is offset by a small chance of a significant loss, should litigation arise. Thus, perceiving liability risk as a sure loss and confining it to an insurance premium makes the possibility of occurrence of liability somewhat more bearable for company directors. Moreover, these instruments provide company directors with the advantage of settlement and the ability to resolve disputes outside the courtroom, where there is less public exposure and less damage to their reputation.

Nevertheless, contractual liability protection does not prevent the threat of litigation. On the contrary, it may in fact increase the risk, as indicated by many of the participants themselves. Thus, company directors still face liability risks in their daily practice. The research demonstrates that the most valued function of D&O insurance and indemnification is the fact that they provide company directors with the resources to restore their personal and professional integrity, albeit by appearing in court. This gives reason to believe that the origin of defensive behaviour may lie in the fear of the threat of public proceedings in which the directors' professional actions and integrity are called into question.

2.4.4.3 Directors' liability legislation

> *'You can cover yourself for everything in the US. There is a need to cover. In the Netherlands, I believe there is a strong principle of reasonableness. As a director you're protected by the reasonableness of the law. So you can't cover everything here. I've never really been sued before, but if the worst case scenario takes place, I've confidence in the Dutch legal system. I strongly feel that if I do my job honestly, I have reasonableness on my side. I chose to run companies that principally want to do nothing illegal. My company believes in the rule of law. So I don't experience any improper pressure, I'm not in conflict with my company. I like that.'*[74]

74. Participant 13, CEO.

There was a common shared feeling among the participants that Dutch law and the Dutch judiciary are reasonable. I observed a shared confidence in the Dutch judiciary among the participants. When faced with the option of settling or litigating, participants tended to choose to litigate in order to seek justice.[75] In general, the participants in this research placed great value on a fair trial. The participants attached major importance to the possibility of explaining and defending their professional decisions. This was important not only to restore their reputation but also to restore their self-confidence.

Nonetheless, the research findings also revealed that, regardless of whether court proceedings generally are fair and judgements are reasonable, there are reasons to believe that the root of the problem underlying defensive behaviour lies not in the fear of a public trial, but in the fact that the actual and perceived liability exposure of directors may not be aligned. In particular, those participants who have been confronted with court proceedings felt that they were highly vulnerable to norms of which they were not aware of beforehand. To illustrate, one of the participants-defendants pronounced the following:

> *'Risk judgements are the prerogative of a director. Judges must stay away from them. They don't know anything about them. Directors aren't afraid of liability. It's just that it's incomprehensible how judges arrive at their decisions.'*[76]

It can be argued that those directors who are being threatened with a claim or are uncertain with regard to a future claim, may also experience concern about unknown norms. As the negative consequences of litigation may be severe, it is not unlikely that directors, uncertain about liability norms, may act unnecessarily defensively in order not be held personally liable.

While court proceedings are perceived to be highly unpredictable and directors are relatively uninformed about liability norms, the asymmetry between perceived and actual liability risks may be attributable to how Dutch courts undertake reviews of directors' actions. Under Dutch law on directors' liability, courts apply the liability standard of 'serious reproach' when determining if a director is personally liable. Serious reproach involves an open norm and its application heavily relies on specific contextual factors. It is in fact established case-law that each individual case requires that courts review 'all relevant circumstances'.[77] Such a review of all circumstances may provide a court with the

75. In practice, the choice to litigate or to settle may be influenced by other factors, such as financial factors and the interests at stake. For instance, the director's interest to pursue litigation versus the company's interest to reduce reputational damage.
76. Participant 30, supervisory director (former executive director).
77. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*).

capacity to arrive at a reasonable outcome in a case. However, it can also be argued that the use of the open liability norm does not enhance the predictability of directors' liability litigation. If the use of such an open norm renders legal decisions unpredictable and thereby generates legal uncertainty, it may contribute to the problematic asymmetry of directors' perceived and actual liability risk.[78] Should the courts fail in providing a clear, understandable and consistent guide of what is acceptable and unacceptable behaviour to directors, the impact of case law may be limited and inadequate in reducing defensive practices.[79]

There is however a great potential for judges to provide directors with guidance on which actions may be beneficial, wasteful, or damaging to the company and to third parties. An important finding in the present study is that company directors seem generally attentive to Supreme Court judgments, particularly when they affect the directors of the larger listed companies. Generally these directors are highly vulnerable to public exposure. The directors interviewed were genuinely interested in the court's determinations regarding appropriate and inappropriate courses of directorial action.

In this respect, there is a ready desire to further formalise 'serious reproach'. One important step forward is to analyse the scope and meaning of the open norm of 'serious reproach' using a representative sample of court decisions involving directors' liability. Such an analysis would be informative about the factors that are determinative in establishing directors' liability and identifying less relevant elements. Formalising the open norm of serious reproach may therefore serve to clarify standards of liability and, accordingly, reduce defensive behaviour.[80]

2.5 Discussion

In this study, I argued that the fear of directors' liability may be reduced and undesirable defensive behaviour may be mitigated without causing negative effects on risk taking, providing there is a strong alignment between threats of

78. Legal certainty has long been held to play an important role in shaping perceptions of liability risks (Shuman 1993, p. 123).
79. Shuman 1993, p. 158.
80. This recommendation should not be regarded as a complete new invention. Kroeze has (albeit in relation to the problem of the hindsight bias) proposed, in imitation of Delaware and Germany, the implementation of a Dutch business judgment rule (Kroeze 2005, p. 18). Assink (2007, 2008) has elaborated on this topic and proposed procedural improvements in judicial decision-making along the lines of good practices regarding Delaware's business judgment rule. The primary aim of my research in Chapter 3 is to identify under the existing 'all relevant circumstances' doctrine, the factors that may form the basis for upholding personal liability or relieving a director of personal liability. All three methods may have the common result of further framing the judicial review of director conduct.

liability and availability of director liability protection. It seems that threats of personal liability do, in fact, form part of directors' pattern of risk concern, but under very specific circumstances: when company directors perceive the risk as certain and directly personally threatening, i.e. when there is fraud or bankruptcy involved. Under these circumstances, the chance of loss, the magnitude of loss, and the exposure to loss are perceived as real and certain and therefore extremely risky.[81]

In March & Shapira's survey,[82] it was found that managers are inclined to take riskier actions when their own positions are threatened. The findings in this research, in fact, suggest that, when company directors are confronted with threats of personal liability, they will act defensively, in particular if they had been subject to previous liability claims. This can be explained as follows. The participants in this research were directors of large companies and were exposed to a wider spectrum of risks than the managers at lower levels of authority. Consequently, these individuals were very aware of the fact that any liability risks in the company might implicate them. They were, furthermore, mindful of not jeopardizing their reputation, as any error could have adverse consequences for other current and future board positions. Moreover, mass media, internet and globalisation may induce directors to engage in defensive behaviour as any error, regardless of magnitude, can be reported throughout the world. Some of the directors with whom I spoke informed me that a number of capable directors had fled to other parts of the world in an attempt to (re)establish their professional status and reputation.

Based on the research into investment games, it can further be argued that company directors are generally more risk averse when dealing with personal threats than with opportunities. As a result the greater the personal threat, the more risk adverse the response, regardless of possible gains.[83] In the present study I found that company directors cope with these extremely risky situations by adjusting the risks, reducing their probability and magnitude or limiting their exposure to losses as a consequence of litigation. The results of this study suggest that contractual liability protection is valuable in enabling company directors to control and adjust the magnitude of and their exposure to losses due to the uncertainty of litigation. This observation does not seem to be trivial. For instance, the possibility of risk adjustment may enable a company director to accept a board appointment in complex organisations or risky industries.[84]

81. MacCrimmon & Wehrung 1986, p. 10; in contrast to Smallman & Smith (2003).
82. March & Shapira 1987, p. 1409.
83. MacCrimmon & Wehrung 1986, p. 115.
84. MacCrimmon & Wehrung (1986, p. 174) have demonstrated that executives would rather modify risks to make a course of action more favourable than choose among the best of a set of risky alternatives. They also argued that executives cope with uncertain projects by at least reducing one of the risk factors: the probability, magnitude or exposure to losses.

Modifying the probability of liability is a more complicated issue. Regardless of the fairness or reasonableness of court judgments, the threat of liability and the likelihood of court proceedings may often be perceived as arbitrary and beyond the director's control. I have noted however that the origin of defensive behaviour may not lie in the fear of public proceedings. Directors are rather uncomfortable with facing uncertainty. Not only do they not know what the actual liability risks are, they are also unfamiliar with the standards of liability. I have suggested that, as a first step, an attempt should be made to provide directors with an understanding of the prevalent standards with regard to liability.

Limitations of the research

Several limitations to the interpretation of the findings need to be recognised. First, this research relied heavily on interviews with senior directors. The primary data thus involves subjective responses in interview settings and is therefore open to biases such as selective memory and social desirability. Moreover, the interviews were conducted one-to-one with no feedback from any other researcher during the process of transcribing the interviews and coding and interpreting the answers. The reliability in interpreting the research results may be regarded as an important weakness of the research. I have attempted to overcome this problem by analysing the interview findings in conjunction with other sources of information: corporate documents, media reports, court decisions, etc. Moreover, as a second stage, I conducted additional interviews with legal professionals, risk managers and insurers to validate the data and to reflect on the findings.

Second, I conducted interviews with senior directors on the highest level of authority in Dutch group companies. Further research examining the views of directors on the level of subsidiaries or the views of directors of smaller companies may provide a fuller view of how company directors perceive liability risks and respond to them. Third, in this study I have focused on large Dutch (listed) companies. Within the Dutch legal context, all directors principally fall under the same legal framework, regardless of whether it concerns directors of the smallest privately owned or the biggest listed companies, or directors of a simple local foundation or the largest complex multinational. The findings of this research may therefore have limited implications. I would like to emphasise that this research does not provide any basis for making general statements about all directors in the Netherlands with regards to their perceptions and attitudes about liability. However, it is important to note that the association between liability risks and defensive practices may also be of concern to the directors of smaller and less complex organisations, especially since they have less information and fewer resources available to reduce liability risks.

Finally, this study was only based on data from the Netherlands, which is a civil law country and known for its moderate litigiousness. An extension of the research to a variety of similar national settings, such as Belgium and Germany, may enhance the validity of the results.

2.6 Conclusion

In this research, I have argued that defensive behaviour may generate a corporate governance problem. It was found that company directors fear liability risks without subjecting them to accurate assessment, and as a result tend to overestimate (or underestimate) liability risks. Based on the findings in this research, it seems that senior directors of major companies are prone to act defensively in situations involving significant reputational risks and perceived certainty of litigation. Prior experience with directors' liability was found to influence how company directors perceive and cope with liability threats.

I have argued that director liability protection may counteract some of the negative effects of (potential) defensive behaviour. Risk reduction and risk avoidance may, under certain circumstances, be prudent management practices. The findings in this research suggest that the corporate governance needs to balance the perceptions of directors' liability risk with the perceptions of the assurance offered by director liability protection. The findings suggest that good corporate governance, from a company law perspective, should encompass instruments that reduce undesirable defensive practices while preserving a significant deterrence against breaches of director duty.

Contractual liability protection primarily reduces the legal and financial liabilities of directors, but cannot exclude the threat of litigation. Although not perfect solutions, these instruments do provide reassurance, as they seem to adequately satisfy directors' demands regarding risk mitigation. Nevertheless, the best solutions would address the factors that trigger defensive behaviour. This study indicates that the Dutch legal framework of directors' liability may be in need of refinement in order to provide greater legal certainty. At present, it is perceived that there are no clear parameters within which to identify acceptable and unacceptable behaviour, and company directors often feel that they are the subjects of arbitrary and public scrutiny.

Viewing directors' liability legislation as a corporate governance instrument inherently encompasses the role of the court as an important guide in a company's good corporate governance. There is considerable potential for courts to shape directors' perceptions of legal threats by increasing the likelihood that

undesirable behaviour will be punished and desirable behaviour will be protected. Clarity about the factors determining liability might not exclude threats of litigation or reputational damage, but could reduce them significantly by guiding company directors in their endeavours to avoid legal threats and ward off arbitrary claims.

APPENDIX I

Figure 1. Participants by gender (N=54)

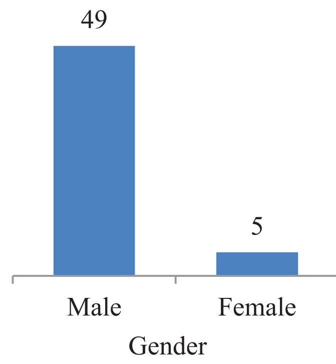


Figure 2. Participants by age (N=54)

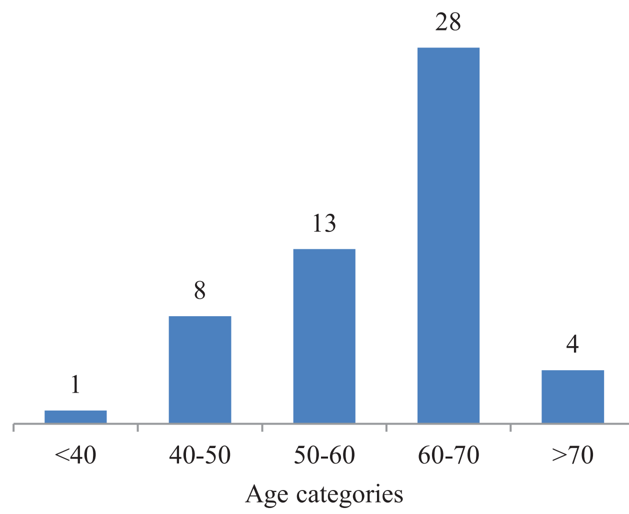


Figure 3. Participants' current experience by sector (note: the number of companies by sector (128) does not equal the number of board positions (125), as some companies are active in more than one sector)

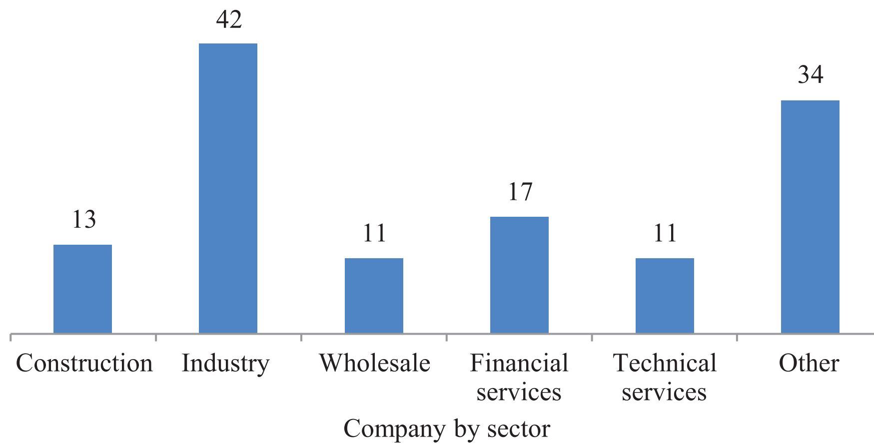


Figure 4. Participants' current experience according to company type (note that almost all participants currently hold positions in multinationals)

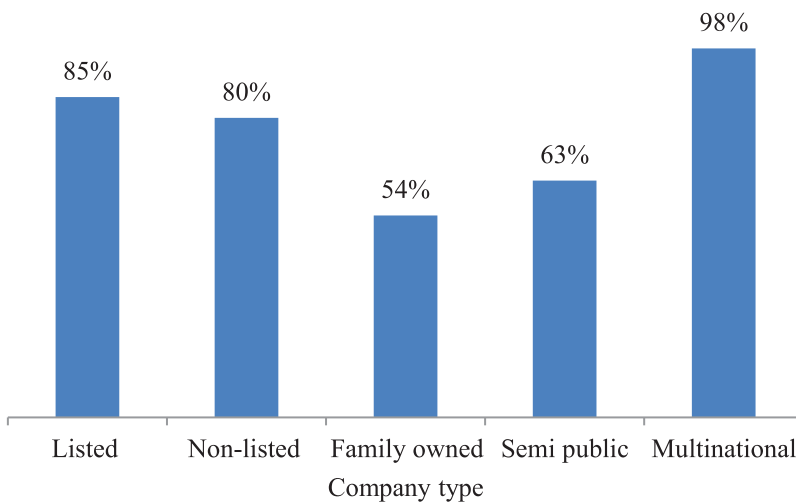


Figure 5. Participants' experience with liability

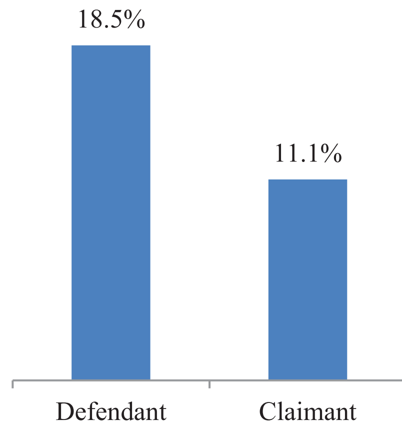


Figure 6. Participants' board positions

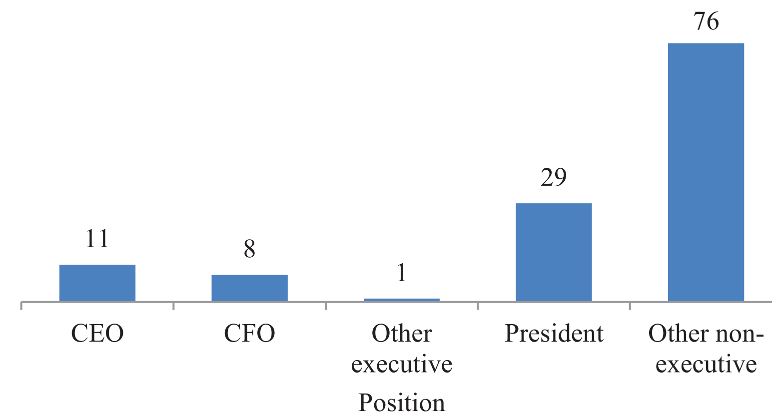
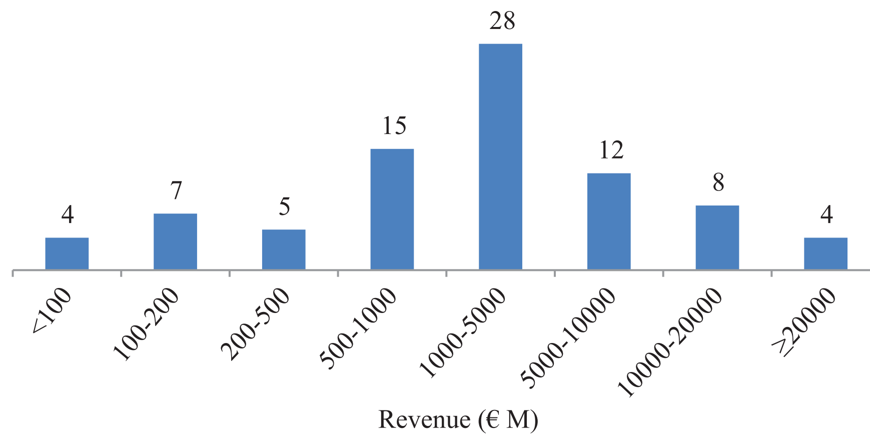


Figure 7. Revenue of the 83 companies under study (based on the company's financial statements for 2012 or most recent financial statements)



APPENDIX II

List of topics for interview with directors

1. Profile:
   - Position(s)
   - Background
     - education
     - experience
     - industry familiarity
   - Participant's characteristics:
     - gender
     - age
     - nationality
2. Perceived directors' liability risks:
   - Perception of responsibilities.
   - Have you been confronted with a directors' liability claim before or are you currently facing a directors' liability claim?
   - Perception of liability risks.
   - Estimation of exposure to directors' liability litigation.
3. Perceived impact of directors' liability risks:
   - In the event of personal experience with directors' liability claims: the impact of the liability exposure on personal life and career.
   - In the event of no personal experience with directors' liability claims: the perception of the most harmful effects of being exposed to a liability claim.
   - Participants' observations as regards peers who are or have been involved in directors' liability litigation.
4. Defensive behaviour:
   - What do you conceive as the most important directors' liability threats?
   - Examples of changes in behaviour.
   - When do you believe that concerns for directors' liability may become problematic?
5. Director liability protection:
   - Measures or instruments that the participant employs to reduce directors' liability risks.
   - Participant's perception of the functions of the instruments.
   - Participant's evaluation of the instruments.
   - What would be your attitude if these instruments were not at your disposal?

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CHAPTER 2

In the Matter of Royal Dutch Petroleum Company and The 'Shell' Transport Trading Co., p.l.c. (SEC Exchange Act of 1934 Release No. 50233, Accounting and Auditing Enforcement Release No. 2085, and Administrative Proceeding File No. 3-11595 (all dated August 24, 2004).

Chapter 3. How courts determine directors' liability. *A jurimetrics study*

3.1 Introduction

The focus of the previous Chapter was on the problem of defensive behaviour among company directors. It was suggested that defensive behaviour may be reduced if directors are better informed about the liability standards that the courts apply when reviewing directors' actions.

The courts may shape directors' perceptions of liability risks by providing more legal certainty about the factors or standards on which they base their legal decisions. This Chapter will therefore examine how courts make decisions in the complex and unstructured legal domain of directors' liability. The research results show that, despite the complex legal environment, court decisions are highly consistent. This study is the first to provide a logistic regression model for predicting directors' liability under Dutch company law based on legal case factors mentioned in court decisions (2003-2013).[1]

This research was conducted in the period 2013-2015.

3.1.1 Research issue: predicting directors' liability on the basis of open norms

Directors' liability is a special legal domain primarily based on open standards and norms. Arguably, the legal domain is inherently complex and unstructured. To establish a director's personal liability, Dutch courts require that a director be subject to 'serious reproach'. The standard of 'serious reproach' was developed in case law as a framework to analyse a director's potential liability to his or her company. As stated in *Staleman v. Van de Ven*, the standard of 'serious reproach' compels courts to consider 'all relevant circumstances' in order to do justice to each specific case at issue.[2] The criteria of 'serious reproach' has been codified in article 2:9 DCC. I understand *Staleman v. Van de Ven* as instructing courts to conduct a multi-factor analysis when reviewing a specific liability case.

1. Parts of this research was published (Pham 2015).
2. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243, par. 3.3.1. (*Staleman v. Van de Ven*).

In paragraph 3.2.1, I will distinguish the relevant circumstances into those involving contextual legal case factors and those involving behavioural legal case factors.

The relevant judicial review has become further complicated in recent years. As I will discuss in detail in paragraph 3.2, 'serious reproach' seems to have been extended so that it now applies to the analysis of directors' liability to creditors and shareholders (art. 6:162 DCC, tortious act) and to the estate in the event of bankruptcy (art. 2:138/248 DCC). The literature suggests that 'serious reproach' is utilised to advance an integrated approach of reviewing directors' liability.[3] This raises the question of whether such an 'integrated approach' invoking the open norm of 'serious reproach' will generate legal uncertainty about court decisions. It is therefore a central focus of this research to investigate the meaning and interpretation of 'serious reproach'. Moreover, within the analytical framework of 'serious reproach' involving the legal reasoning based on all relevant circumstances, I will endeavour to determine the contextual and behavioural legal case factors that are most influential when assessing directors' liability. Finally, I will furthermore investigate how well these legal case factors may predict case outcomes in order to determine the extent of consistency in legal decision-making.

3.1.2 Research question

In accordance with the foregoing, I will be assuming that Dutch courts apply 'serious reproach' to three theoretically distinct sets of legal disputes: directors' liability to the company (art. 2:9 DCC), third parties such as creditors and shareholders (art. 6:162 DCC) and the estate in the event of bankruptcy (art. 2:138/248 DCC). This is not to say that claimants may strategically base their claims on more than one legal ground and amass the set of legal facts to increase the likelihood of a legal decision in their favour.

The research question is threefold:
- How can 'serious reproach' be formalised?
- Which legal case factors – contextual and behavioural factors – can be deduced from the analytical framework of 'serious reproach' and are most influential for adjudicating directors' liability?
- What is the extent of consistency in legal decision-making based on the legal case factors – contextual and behavioural factors – obtained from the analytical framework of 'serious reproach'?

3. Timmerman 2009, p. 481.

To explore the research questions, I will qualitatively and quantitatively analyse a set of court decisions.[4] I will first perform a qualitative analysis of several land mark cases in which the Supreme Court has presumably applied the standard of 'serious reproach'. This legal study will serve as a stepping stone to the construction of a simple legal decision model with 'serious reproach' providing the basis on which a director may be deemed personally liable. Dutch courts arguably apply this simple model in managing the complexity of individualised, context-based, case-by-case-judgments. I will test the simple model quantitatively, taking into consideration multiple relevant legal case factors in accordance with the 'all relevant circumstances' doctrine prevalent in *Staleman v. Van de Ven*. In so doing, I intend to combine bivariate analysis and logistic regression analysis to determine the legal case factors that are most influential in evaluating directors' liability. Bivariate analysis provides insight into the independent effect of each of the predictor variables on directors' liability. The bivariate analysis will be followed by a logistic regression analysis with the aim of determining the combined effects of the most relevant legal case factors on the case outcome, whether the director was found personally liable or not. Moreover, I will determine the predictive value of these legal case factors in order to draw conclusions about the consistency of legal decision-making.

It should be noted here, perhaps superfluously, that I am focusing this research on legal case factors that have occurred in court decisions, hence making use of case factors that have already been legally interpreted by courts. After all, the purpose of this research is to understand directors' liability legislation as manifested in extant legal decisions.[5]

3.2 Directors' liability and legal certainty: a qualitative analysis

3.2.1 The (un)problematic nature of the open norm: serious reproach

The point of departure for this research is directors' liability under Dutch company law.[6] In this highly dynamic field of law, three concepts of directors' liability are dominant: the joint and several internal liability of directors to the company (art. 2:9 DCC); the joint and several external liability of directors in the event of bankruptcy (art. 2:138/248 DCC); and the external liability of

4. Note that the legal quantitative analysis was restricted to a sample of court decisions (2003-2013). See paragraph 3.3.2 for the details on data characteristics and collection.
5. Hall & Wright 2008, p. 64 (distinguished between empirical legal research focusing on the effects of the law and empirical legal research focusing on understanding the law).
6. See for an overview of some key developments regarding the civil, criminal, and administrative aspects of directors' liability B.F. Assink et al. 2011.

individual directors to third parties for wrongful acts (art. 6:162 DCC).[7] If one of these standards of conduct is violated, a director may fall prey to a court's judicial review.

It has been argued that statutory liabilities are the subject of the Dutch Supreme Court's integrated approach of 'applying the standard of 'serious reproach' when reviewing directors' liability.[8] Serious reproach – the standard required to establish directors' liability – was first introduced in 1997 in the Supreme Court's ruling in *Staleman v. Van de Ven*.[9] The liability standard instructs courts to consider 'all relevant circumstances' when undertaking the liability analysis. Several circumstances may be relevant, such as the nature of the company's activities, the risks related to these activities, the division of tasks within the board of directors, any relevant guidelines to which management should adhere, the information available to management and the care and competence expected from management.[10] I understand these circumstances to involve relevant contextual and behavioural legal case factor, which may be distinguished as follows: contextual factors may colour a court's perception of a director's (mis)behaviour. Contextual factors alone, however, may not lead to a director's personal liability. This is precisely the distinction between corporate liability and a director's personal liability. There must be individual misbehaviour – a behavioural factor – for which a director can personally be reproached, including but not limited to a norm violation or foreseeable damage on the part of the director (see paragraph 3.3.3 for more details on how contextual and behavioural legal case factors have been operationalised).

Since courts enjoy the discretion of context-based review, the points of view in *Staleman v. Van de Ven* should not be regarded as constraints on the courts' considerations of directors' liability. The only certain limitation is the requirement of objective judicial review of directors' conduct.[11] In other words, a director's subjective bad faith or subjective incompetence or knowledge are, theoretically, irrelevant factors in the liability analysis. Or at least, claimants are not required to prove a director's bad faith and courts are not obliged to infer a director's bad faith in order to establish a director's' liability. In practice, given the circumstances, a director's subjective state of mind may be relevant.

7. The statutory liabilities also apply to supervisory directors with respect to their supervisory duties (art. 2:140/250 DCC). In this Chapter, I use the term 'director' to refer to executive directors and supervisory directors and in the context of external liability, *de facto* directors.
8. Timmerman 2009, p. 481.
9. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243.
10. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243, par. 3.3.1.
11. In the context of internal liability (*Staleman v. Van de Ven* 1997:3.3.1), external liability (*Kloosterbrink v. Eurcommerce* 2009:4.6) and bankruptcy liability (*Panmo I* 2001:3.7).

There are indications in case law that, where a court does infer or establish that a director had acted with malicious intent, the bad faith action on its own may establish a director's personal liability. A well-known 'bad faith' case involves *De Rouw v. Dingemans*, where the director committed fraudulent acts and was judged personally liable to the company.[12] Moreover, there are indications in case law that, where a court does infer that a director was in an advantaged position of knowledge, this position may influence the case outcome. For instance, the *Altera Pars Media* case involves the appointment of an Imca employee as the sole director on Altera's board in anticipation of a proposed merger between Altera and Imca. The Disctrict court assumed on the basis of the director's position that the director knowingly continued Altera's financial policy to the detriment of Altera's companies.[13]

'Serious reproach' is thus an open norm suitable for flexible application to different types of legal disputes and differing circumstances. In spite of this advantage, the use of a flexible, open norm is susceptible to criticism as it may increase legal uncertainty.[14] When it comes to judicial review, the courts have to apply the open standard of serious approach to individual, context-specific circumstances, thus enhancing legal uncertainty.[15] In this research, I hypothesise that legal uncertainty is reduced *because* the Supreme Court has adopted 'serious reproach' as the analytical framework for different types of legal procedures to review director conduct. I will demonstrate that, based on an analysis of several key Supreme Court decisions, 'serious reproach' serves to construct and maintain a simple legal decision model intended to overcome the inherent complexity and unstructured nature of context specific, case-by-case judgments. The Supreme Court's analytical framework of 'serious reproach' will be shown to follow a logical pattern: (1) courts identify norms that may have been violated; (2a) they objectively assess the degree to which these violations can be reproached; (2b) in so doing, they consider all relevant circumstances with respect to the defence advanced by the director concerned. I will refer to this model as the Supreme Court's 'simplified legal decision model' and will now elaborate on how it may operate when courts apply 'serious reproach' to different types of legal disputes concerning directors' liability.

12. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
13. District Court, 21 November 2007, ECLI:NL:RBAMS:2007:BC1308 (*Altera Pars Media B.V.*).
14. Assink 2011; Kroeze 2005, p. 16-19.
15. Borrius 2011, p. 248; B.F. Assink 2011.

3.2.2 Internal directors' liability – article 2:9 DCC

The directors' liability pursued by (non)bankrupt companies is generally based on art. 2:9 DCC. Each director is required to offer the company proper performance of management duties, and is jointly and severally liable should he or she be deemed subject to 'serious reproach'. 'Serious reproach', hence liability, is presumed if a director violates internal norms intended to protect the company. The focus of the liability analysis on violations of internal norms can be best understood by considering their significance when specifying director' duties or formalising how these duties should be performed. In *Staleman v. Van de Ven*,[16] the company instigated new activities of financial leasing of automobiles. The directors were instructed to only provide customers lease of second-hand automobiles which were in stock. As the new activities were intended as a pilot, an aggressive strategy was not preferred. Contrary to this policy objective, the directors pursued a policy resulting in high volumes of newly acquired second-hand models, causing the company financial problems. In *Schwandt v. Berghuizer Papierfabriek*,[17] provisions in the articles of association limited the director's discretion with regard to certain business decisions. A director knowingly granted an option to purchase the shares in Xeikon and the sale of those shares to ISTD below market price and without the required approval of the supervisory board. It was later discovered in a criminal proceeding that the director had acted fraudulently by concealing his involvement with ISTD and unjustly obtained personal benefits as a result.

The degree to which 'serious reproach' can be established depends on the severity of the norms that have been violated. In the examples discussed above, the purpose of the internal norms was to protect the interests of the company. In *Staleman v. Van de Ven,* the norms, in the given context, were meant to protect the company from exposure to excessive risks. In *Schwandt v. Berghuizer Papierfabriek*, the circumstances of the case revealed that the norms were supposed to protect the company from the director's self-dealing.

In the same line of reasoning, it can be argued that when internal norms have the limited purpose of protecting the company's interests, the violation of that norm may not amount to a 'serious reproach'. Directors are thus given the opportunity to indicate circumstances that refute the presumption of liability. In *Broekmans Beheer v. BRR Participaties*,[18] the director violated internal

16. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243, *NJ* 1997, 360 with case note J.M.M. Maeijer.
17. Supreme Court, 29 November 2002, ECLI:NL:HR:2002:AE701.
18. Court of Appeal Arnhem, 20 December 2011, ECLI:NL:GHARN:2011:BV0325.

norms by performing several legal acts without the approval of the general shareholders' meeting. The director successfully demonstrated that decision-making within the formal framework of the general meeting of shareholders had been lacking for years and that BRR had simply allowed things to run their course. Under these circumstances, the director's action could not be the subject of a 'serious reproach'.[19]

3.2.3 Liability for wrongful acts – article 6:162 DCC

Directors are obliged to consider the interests of third parties, including creditors and shareholders. A claim of directors' liability may be pursued by third parties if it is based on a wrongful act within the meaning of art. 6:162 DCC (generally accepted standards of care). For a director to be held liable, the director's action must however also qualify as 'seriously reproachable'.[20]

In *Ontvanger v. Roelofsen*, the Supreme Court distinguished two categories of wrongful acts that may give rise to 'serious reproach'.[21] The first category involves a director who pursues a new obligation on behalf of the company while he or she knows or should have known that the company will not be able to meet that obligation in a timely manner (e.g. insufficient liquidity) and is

19. Based on the cases cited in this study, I found only one case in which the director violated an internal norm and was able to successfully refute the presumption of liability.
20. In the conclusion of *Westland v. Schieke* (2007), A-G Timmerman considered that under art. 2:9 DCC, the standard of liability, 'serious reproach', was higher than the ordinary standard of liability under art. 6:162 DCC. A mere wrongful act was insufficient to hold a director liable. Sufficient 'serious reproach' was required (Supreme Court, 2 March 2007, ECLI:NL:HR:2007:AZ3535 conclusion by A-G Timmerman, 2 March 2007, ECLI:NL:PHR:2007:AZ3535 (*Westland v. Schieke*).
21. Supreme Court, 8 December 2006, ECLI:NL:HR:2006:AZ0758, conclusion by A-G Timmerman, 8 December 2006, ECLI:NL:PHR:2006:AZ0758 (*Ontvanger v. Roelofsen*). Categories other than the typical wrongful acts in the meaning of *Ontvanger v. Roelofsen*, have been acknowledged to amount to serious reproach. In Supreme Court 11 February 2011, ECLI:NL:HR:2011:BO9577, par. 3.3 (*Nilarco*), it was considered that a wrongful act may involve 'insufficient account of the legitimate interests of creditors and thereby limiting the possibility of redress of the creditors concerned'. In the final judgment (after referral), the Court of Appeal ultimately ruled that the director concerned, directly and indirectly derived a personal benefit from the 'tile transaction' while he knew or should have known that such an act would cause substantial harm to the bankrupt estate (and indirectly to the receiver as one of the creditors in the bankruptcy), Court of Appeal s-Gravenhage, 12 March 2013, ECLI:NL:GHDHA:2013:624, par. 6-10. It is important to note that the type of wrongful act may be contexually driven, however, to be able to assume personal liability, serious reproach requires that a director could have reasonably foreseen damage to the third party concerned. See also conclusion A-G Timmerman, 21 November 2014, ECLI:NL:PHR:2014:2242, par. 3.7 and 3.12, prior to Supreme Court, 27 Februari 2015, ECLI:NL:HR:22015:499 (*ING v. X*).

unable to provide sufficient recourse (e.g. insufficient solvency).[22] The second category concerns a director who frustrates the payment of an outstanding amount and the possibility of recovery to the detriment of a creditor. For both forms of wrongful acts, liability is assumed if the director could have foreseen the damage to the creditors concerned.[23]

The degree to which a director can be considered as 'seriously reproachable' if there was foreseeable damage to a creditor can be best understood with respect to the legal personality of a company.[24] Under Dutch company law, the company is primarily liable towards third parties (art. 2:5 DCC) as distinct from a directors' personal liability towards that third party, the latter being regarded as a secondary form of liability.[25] In the conclusion of *Ontvanger v. Roelofsen*, A-G Timmerman considered that some knowledge on the part of the director regarding risk of damage to a creditor is insufficient for holding a director liable.[26] A stricter interpretation of serious reproach requires that the director could have reasonably foreseen that the movement of the company's assets would be detrimental to the creditor concerned. Accordingly,

22. Also known as the Beklamel-norm (Supreme Court, 6 October 1989, ECLI:NL:HR:AB9521, *NJ* 1990, 286); again confirmed in Supreme Court, 5 September 2014, ECLI:HR:2014:2627, par. 4.3 (*RCI Financial Services v. Kastrop*). Moreover, the Supreme Court ruled that RCI had insufficiently stated that the damage suffered by RCI as a result of the fact that RCI did not receive first right of pledge was foreseeable at the time that the director pursued the obligation on behalf of the Kastrop companies (par. 4.5). Evidently, the Court could not infer on the basis of this circumstance that RCI, contrary to what was agreed, received a second right of pledge and suffered damage as a result (par. 4.3).
23. It is important to recognise that for assuming external directors' liability, existing case law does not exclusively require foreseeability of damage on the part of a director (*Ontvanger v. Roelofsen,* par.3.5; *Intertrust v. Ontvanger*, par. 3.6.2). For instance in Supreme Court, 4 April 2014, ECLI:NL:HR:2014:829 (*X v. Ingwersen*), the director consciously placed the company in default of payment to the detriment of Air Holland. In the specific case, the director knew that Air Holland had a (residual) cash claim against the company. Despite this knowledge, the director decided to transfer the company's assets to a sister company without making final arrangements to provide Air Holland with remedy (par. 3.2) (see also the conclusion by A-G Timmerman, 20 December 2013, ECLI:NL:PHR:2013:2389, par. 1.10, citing the Court of Appeal Arnhem, 27 November 2012, ECLI:NL:GHARN:2012:BY5416, par. 4.8-4.9).
24. Assink et al. 2011, p. 30.
25. Supreme Court, 2 March 2007, ECLI:NL:2007:AZ3535 (*Westland v. Schieke*). See also Supreme Court, 8 December 2006, ECLI:NL:HR:2006:AZ0758, conclusion by A-G Timmerman, 8 December 2006, ECLI:NL:PHR:2006:AZ0758, par. 5.5-5.6 (*Ontvanger v. Roelofsen*).
26. Conclusion by A-G Timmerman, 8 December 2006, ECLI:NL:PHR:2006:AZ0758, par. 5.7 (*Ontvanger v. Roelofsen*).

directors are given the opportunity to demonstrate that, in the light of the circumstances, they could not in fact have reasonably foreseen damage to creditors.[27]

3.2.4 Liability in the event of bankruptcy – article 2:138/248 DCC

Directors may also face a claim filed by the bankruptcy trustee representing the interests of the creditors collectively under art. 2:138/248 DCC. To establish directors' liability, the director must have demonstrably engaged in manifestly improper management and the improper management was an important cause of the company's bankruptcy. Provided that these conditions are satisfied, a director can be held jointly and severally liable to the bankrupt estate (art. 2:138/248[1] DCC) with the restriction that these type of claims can be filed only on the ground that the improper management took place in the period of three years preceding the company's bankruptcy. Discharge does not preclude such claim (art. 2:138/248[6] DCC).

In reviewing a director's conduct under bankruptcy, I am further assuming that the courts use the concept of 'serious reproach' to hold a director liable in the face of foreseeability of damage. I assume that manifestly improper management implies 'serious reproach'. According to parliamentary history, the element 'reproach' should be read as implicit in the term 'improper management'. The term 'manifestly' should be understood as an expression of the severity of the reproach that can be made against the director. In other words, 'the improperness of the director's action must be beyond doubt'; otherwise the director cannot be held liable.[28] Moreover, I understand the Supreme Court's decision in *Panmo I* and *Panmo II* as consistent with the notions in parliamentary history, insofar as manifestly improper management as prescribed in art. 2:138/248 DCC requires that a director can be seriously reproached for his actions or omissions.[29]

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27. As was successfully demonstrated in Court of Appeal 's-Hertogenbosch, 12 April 2007, ECLI:NL:GHSHE:2007:BC1129 (*Berkbouw B.V.*).
28. House of Representatives of the States General, Wijziging van bepalingen van het Burgerlijk Wetboek en de Faillissementswet in verband met de bestrijding van misbruik van rechtspersonen, 16631 no. 6, 1983-1984, p. 4.
29. Supreme Court, 8 June 2001 ECLI:NL:HR:2001:AB2053, par. 3.7 (*Panmo I*) and ECLI:NL:HR:AB2021, par. 4.7 (*Panmo II*), citing the Court of Appeal 's-Gravenhage, 8 June 1999, 'manifestly improper management [in terms of art. 2:138/248 DCC, TP] implies that directors can be subject to serious reproach for [their, TP] misbehaviours in the knowledge – objectively determined – that creditors may suffer damage as a result.' See also Supreme Court, 12 February 2016, ECLI:NL:HR:2016:233, par. 3.5.2 and the conclusion by A-G Wuisman, 20 November 2015, ECLI:NL:PHR:2015:2290, par. 2.13.

Moreover, I assume that, relative to the aim of protecting creditors under art. 2:138/248(1) DCC, there must be serious violations on the part of a director in order to find the director to be liable. There are indications in case law suggesting that foreseeability of damage to the creditors of the company is an important criterion for establishing the liability of directors.[30] In the *Panmo* cases, the board of Panmo decided that, as part of a rescue plan, the company's equity capital would be encumbered with the debts of Scarpa, one of the company's subsidiaries. By accepting the risk of an irrecoverable debt, the board increased the company's financial risk. The Supreme Court reasoned that the board's course of action did not involve reasonable knowledge that the creditors of the company would suffer damage.[31] I understand this reasoning in *Panmo I* and *II* as implying that foreseeability of damage to creditors is an important criterion for courts when adjudging a director liable to a bankrupt estate. *Panmo* was later applied in *Lébol Kittechnieken B.V.* and *Vonos Group B.V.* in which the criterion of foreseeability of damage was made explicit.[32]

The majority of the claims in the event of bankruptcy are, however, based on art. 2:138/248(2) DCC. Under these articles, liability is presumed if the director violates the following statutory obligations: the duty to maintain proper bookkeeping (art. 2:10 DCC) and the duty to publish the financial statements timely (art. 2:394 DCC). If the director does not comply with one of these statutory obligations, said director may be irrefutably presumed [onweerlegbaar vermoeden] to perform the required duties in a manifestly improper manner (art. 2:138/248[2] DCC). If the company indeed goes bankrupt, it may be furthermore refutably presumed [weerlegbaar vermoeden] that the manifestly

30. Consider the line of reasoning in House of Representatives of the States General, Wijziging van bepalingen van het Burgerlijk Wetboek en de Faillissementswet in verband met de bestrijding van misbruik van rechtspersonen 198-1984, 16631 no. 6, p. 21, manifestly improper management implies, 'that a director acted irresponsibly with the knowledge – objectively determined – that creditors would suffer [damage, TP] as result.'
31. See the same line of reasoning in Court of Appeal Leeuwarden, 30 January 2008, ECLI:NL:GHLEE:2008:BC3428, par. 13 (*Bokma Reclamebureau B.V.*) referring to *Panmo*.
32. In *Lébol Kittechnieken B.V.*, several misbehaviours (neglect of duties, improper financial administration, selective non-payment and improper abstraction of company assets) accumulated and resulted in the court's assumption of the director's foreseeability of damage to creditors (Court of Appeal 's-Gravenhage, 28 August 2008, ECLI:NL:GHSGR:2008:BF1833, par. 26). In *Vonos Group B.V.*, the district court placed the cause of Vonos' bankruptcy in the fact that, without having arranged proper funding, the director caused the company to incur obligations which the company was unable to meet without the specific funding (District Court Amsterdam, 21 March 2007, ECLI:NL:RBAMS:2007:BA4517, par. 4.8).

improper performance was an important cause of the bankruptcy (art. 2:138/ 248[1] DCC), providing that an immaterial omission [onbelangrijk verzuim] was not at issue.[33] To escape liability, the burden of proof rests with the director to show that the bankruptcy was the result of external circumstances other than improper performance.[34]

3.2.5 Formalising 'serious reproach'

Directors' liability litigation may be based on different legal grounds (art. 2:9, 6:162, 2:138/248 DCC). In the preceding paragraphs, I assumed nonetheless that Dutch courts apply 'serious reproach' as the basis of an analytical framework to review the distinct liability claims. Under the analytical framework of 'serious reproach', courts are obliged in each given case to consider all relevant circumstances. I have argued that this open and flexible approach to review directors' liability may not be problematic. Moreover, I have argued that the integrated approach to judge directors' liability litigation by applying the standard of 'serious reproach' allows courts to construct and maintain a simple legal decision model while managing the complexity of contextualised case-by-case judgment. In paragraphs 3.2.2-3.2.4, I outlined the pattern of legal reasoning during such deliberations: first and foremost, courts identify norms that may have been violated; second, they objectively assess the degree to which these violations can be reproached. In so doing, they consider all relevant circumstances with respect to the defence advanced by the director concerned (paragraph 3.2.1).

Accordingly, based on the analysis in paragraphs 3.2.2-3.2.4, I presume that the simple legal decision model involves 'serious reproach' at the base and formalise 'serious reproach' as involving a violation of a norm – on the condition that the norm was specifically addressed to a director – for which a director can be reproached, in view of the severity of the violation and all relevant circumstances at issue.

In the following quantitative part of the research, I intend to test the aforementioned simplified model. For this purpose I assume that it is very likely that courts deliberate on directors' liability whenever one of the categories of litigious actions under (1) and/or (2) are in play:

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33. I will not discuss the issue of immaterial omission in this research and would like to make reference to Supreme Court, 1 November 2013, ECLI:NL:HR:2013:1079, par. 3.6.2 (*Verify*). In *Verify* the Supreme Court considered that an immaterial omission is at issue when a director does not fulfil his obligations required in art. 2:248 DCC, but, given the circumstances, this violation does not indicate improper performance of duties.
34. Supreme Court, 30 November 2007, ECLI:NL:HR:2007:BA6773, par. 3.4 (*Blue Tomato*).

(1) The director violates a norm specifically addressed to him or her, involving:
    a. violation of internal norms meant to protect the company;
    b. violation of statutory norms with respect to proper bookkeeping and timely publication of financial statements meant to protect the company's creditors.
(2) The director violates a standard of care specifically addressed to him or her (the generally accepted standards in the meaning of *Ontvanger v. Roelofsen*) on account of which the company's creditors are foreseeably likely to suffer damage as a result.

It is important to note that foreseeable damage (with regards to the company, or company's creditors or shareholders), if raised by litigants, may be a relevant circumstance for judicial review, regardless of the legal ground on which a claim is based (art. 2:9, 6:162, 2:138/248). The importance of foreseeable damage is not solely reserved for directors' liability to creditors in the context of art. 6:162 DCC. I argued for its relevance in the context of liability during bankruptcy.[35] In the case of a 2:9 claim, such a claim generally depends on violations of norms relating to a director's duty.[36] It goes without saying however, that if well pleaded, foreseeable damage to the company may be an important circumstance for holding a director personally liable to the company in any given case.[37]

As we now move forward to the quantitative part of the research requiring the coding of court decisions and construed legal circumstances involving measurable legal case factors, I will speak of 'norm violation' when referring to the actions under (1), and 'foreseeability of damage' when referring to the actions under (2). Importantly, when I code a case as involving a director's 'foreseeability of damage', I implicitly recognise that a director has violated a specific norm addressed to him or her. Finally and in accordance with the foregoing, I understand the factor of 'foreseeability of damage' to involve damage to the company and/or the company's creditors.

35. See paragraph 3.2.4.
36. See paragraph 3.2.2. See also Assink 2016, par. 28-30.
37. For instance, District Court Amsterdam, ECLI:NL:RBAMS:2007:BC1308, par. 4.4 (*Altera Pars Media B.V.*). Note that, in this particular case, the 2:9 claim was instigated by the trustee in bankruptcy for the benefit of the bankrupt estate.

3.3 Analysing court decisions quantitatively

3.3.1 Focus of quantitative analysis using Dutch court cases (2003-2013)

The central focus in this quantitative part of the research is to determine, based on a sample of court decisions (2003-2013), which contextual and behavioural factors of legal cases are most influential in determining directors' liability within the analytical framework of 'serious reproach'. Accordingly, the quantitative analysis will focus on measuring the relationship between the courts' decisions (the ruling on whether the director was personally liable) and several predictor variables (contextual and behavioural legal case factors). The predictor variables are thus legal case factors that are presumed to affect the case outcome.

In paragraph 3.2.5, I assumed on the basis of legal analysis that courts generally evaluate directors' liability using a simple legal decision model. Within this model, I argued that the factors of 'norm violation' and 'foreseeability of damage' are important in establishing directors' liability. In this quantitative part of the research, I will put this simplified model to a test. As established case law prescribes a multi-factor analysis of directors' liability,[38] which may cause a court to deem a director to be personally liable, I will attempt to analyse and compare the independent effects of several relevant contextual and behavioural legal case factors on the case outcome and calculate their predictive value. Before discussing the results, I will elaborate on the characteristics of the sample of court decisions and how I selected the cases. Subsequently, I will indicate how I have coded the decisions to enable statistical analysis. Finally, I will pay some attention to the statistical strategy used in this research.

3.3.2 The data: characteristics and selection

Analogous to the legal analysis in paragraph 3.2, this quantitative analysis is based on a sample of court decisions involving directors' liability based on articles 2:9, 6:162 and 2:138/248 DCC.

Cases were collected using the online database of *'Jurisprudentie Onderneming & recht (JOR)'*, a legal journal specialising in Dutch company law. Using the keyword *bestuurdersaansprakelijkheid* [directors' liability], the search provided

38. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243, *NJ* 1997, 360 (*Staleman v. Van de Ven*). And emphasised in Assink et al. 2011, p. 33.

a total number of over 300 court decisions in the period from 1 January 2003 to 1 September 2013.[39] It was decided not to include court cases that had been published too recently, mainly because these cases may not yet have included a final judgment on a director's personal liability.

The sample included court decisions from the District Courts, Courts of Appeals and the Supreme Court in which the courts ruled on the personal liability of a director. To increase the likelihood that the court cases involved a final judgment, I checked the online database of 'Rechtspraak.nl', a government-owned database, and searched each case individually. For some cases, I found that one of the parties had indeed appealed, and opted to include these cases in the statistical analysis instead. In several Supreme Court cases, the court did not decide on the directors' personal liability but referred the cases to lower courts for final judgment. I requested all these judgments. Some courts were willing to provide assistance.

The cases were read and manually filtered so that only relevant cases were retained for statistical analysis. Whenever cases were excluded, they were rejected for the following reasons:
- The case did not involve directors' liability;
- Although directors' liability was at issue, the procedure was mainly concerned with other matters, such as the competence of the claimant, whether the defendant was a director, whether there was damage, the allocation of damage or the law of evidence;
- The case involved directors' liability but the legal analysis was not based on the legal grounds that were the object of this research;
- The case did not involve a final judgment in which the court decided that the director was liable or not;
- The case did not fall within the period of 1 January 2003 to 1 September 2013.

Applying these criteria, the sample was limited to 119 court decisions.[40] In 24 of these decisions, the court differentiated the liability analysis in order to target specific directors individually involved in the given case. As a result, the 119 court decisions enabled me to code 158 cases for the purpose of statistical analysis, allowing the statistical sample to comprise 158 coded cases from 1 January 2003 to 1 September 2013, all involving a judgement of a director's personal liability based on articles 2:9, 6:162 and 2:138/248 DCC.

39. The online database was accessed in the period from 1 October to 1 December 2013.
40. The list of cases is included in Appendix II.

Of the 158 coded cases, I found that in 104 cases (66%), courts ruled that directors were liable. These rulings were legally based on art. 6:162 DCC in 39% of the coded cases, on art. 2:138/248 DCC in 38% of the coded cases and on art. 2:9 DCC in 23% of the coded cases. In Figure 1, I further distinguish the rulings of 'liable' or 'not liable' in the158 coded cases into categories where directors displayed 'subjective bad faith' and' 'lack of good faith'. The illustration shows that, for the larger part, a director was held liable due to action in subjective bad faith (57%). Figure 2 displays the sample of 158 coded cases in chronological order. The trend line shows a slight increase in the number of directors being found personally liable.

Figure 1. Ruling by category (N=158)

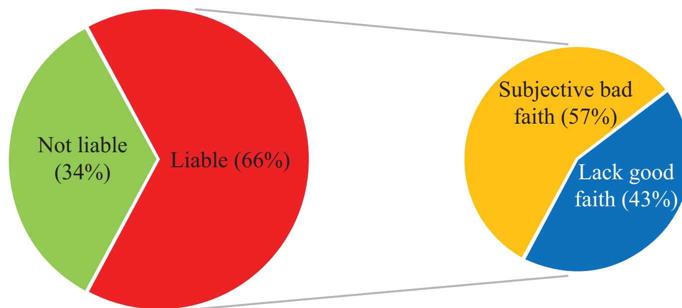
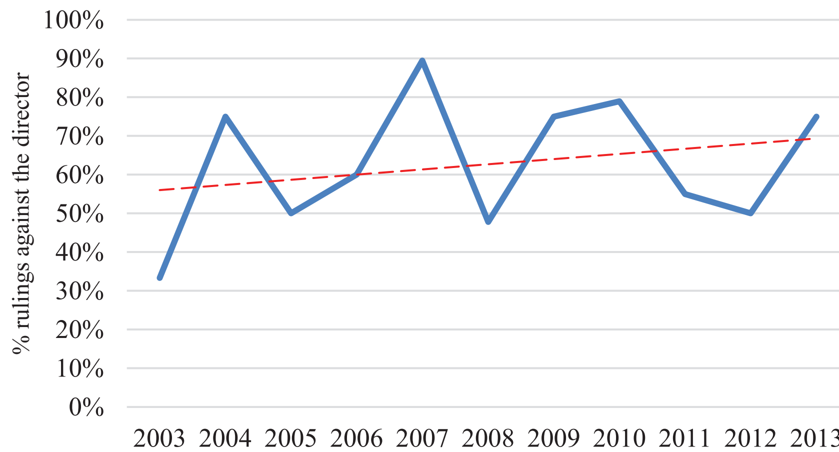


Figure 2. Percentage of director liability cases where a court found the director personally liable, from 1 January 2003 to 1 September 2013 (N=158)



3.3.3 Coding dependent and independent variables

Making use of the selected court cases, I coded the legal case factors that, according to the legal decision, were involved in each case. The choice in this research to code the legal case factors involved in the court cases under study instead of 'simple' case factors means that the factors utilised for statistical analysis have already been legally interpreted by a court. For the sake of clarity, it should be noted that the intent of this research is not to investigate how courts perceive and interpret 'simple' case factors and perhaps qualify them as legally relevant, but to determine the legal case factors most relevant to a ruling in the attempt to better formalise 'serious reproach'.

In accordance with the assumptions made in the legal analysis, I used the framework of 'serious reproach' as described in *Staleman v. Van de Ven* as the starting point and focused on coding the contextual and behavioural legal case factors that were implicated in this and other rulings.[41] I coded *contextual legal case factors* involving the different types of corporate settings that may have been the breeding ground for the legal dispute, such as 'bankruptcy', 'mismanagement', 'policy failure' and 'misrepresentation of information'.[42] These factors are distinguished from *behavioural legal case factors*,[43] which involve the court's perception of the (mis)behaviour of a director in a given case, such as whether the director had violated a norm ('norm violation'), could have foreseen damage to the company or to the company's creditors ('foreseeability of damage'), took unreasonable risks ('unreasonable risk taking'), failed to make reasonable efforts to be informed ('unreasonably informed'), was not competent for the tasks assigned to him as a director ('incompetence'), neglected a known duty to act ('dereliction of duty'), had a conflict of interest ('conflict of interest'), had acted with the intent to do harm to the (stakeholders of the) company (including fraud and forgery) ('subjective bad faith'). I also defined 'limitation of personal liability' as a behavioural legal case factor, as a director may invoke legal means to effectively limit his personal liability as part of a legal defence (e.g. relying on a discharge, an allocation of duties

41. See paragraphs 3.1.1 and 3.2.1.
42. As I explained in paragraph 3.2.1., contextual legal case factors may not alone lead to a director's personal liability.
43. The distinction was made in consideration that a court's finding of corporate liability may not establish the personal liability of the director. As I explained in paragraph 3.2.1, there must be an individual misbehaviour for which a director can personally be reproached.

within the board of directors or exculpation). For a further overview and description of the factors used in this research, see the Appendix I.[44]

I would like to draw attention to two legal case factors: 'subjective bad faith' and 'foreseeability of damage'. Courts do not generally use the term 'subjective bad faith' in their decisions. I use the term to refer to instances where a court stated in its decision that the director under review had committed a criminal offence such as fraud or forgery or had unjustly enriched him- or herself, had manipulated or concealed (financial) data or other relevant information, had intentionally or purposefully caused harm or damage to the company or the company's stakeholders, or had carried out his or her actions for personal benefit while disregarding the interests of the company or the company's stakeholders. I defined these types of director behaviours as actions intended to do harm to (the stakeholders of) the company.[45] Furthermore, I regarded these acts of 'subjective bad faith' as distinct from director conduct in the knowledge of potential damage. A case involving foreseeable damage for which a director can be subject to 'serious reproach' may not mean that the case also involves a director's 'subjective bad faith'. A director may, for instance, issue what later proves to be inaccurate financial information on behalf of the company without the director's action being necessarily fraudulent at the time of issue. Other circumstances, such as structural administrative failures, may be implicated, and it may furthermore be that a director is susceptible to 'serious reproach'.

Existing case law does not, however, prescribe 'foreseeability of damage' as a criterion to be satisfied in order to establish a director's liability to a company (art. 2:9 DCC) or, in the context of bankruptcy (art. 2:138/248 DCC), to the bankrupt estate.[46] Nevertheless, this does not exclude the fact that the assumption of damage being 'reasonably foreseeable' to a director may influence a

44. I included the coding scheme in the Appendix I. In the coding scheme, I also provided several other factors, such as the type of legal dispute at issue, the type of court that rendered the legal decision, the capacity of the defendant (involving management board, supervisory board, individual executive director, individual non-executive director, sole director, de facto director), and the capacity of the claimant (company, creditor, trustee in bankruptcy, shareholder). It must be noted however that the quantitative research was not aimed at analysing the effects of these other factors on the case outcome. Further, I indicated the frequency of observations of the factors used in this research.
45. Illustrative examples include *Schwandt v. Berghuizer Papierfabriek* (discussed in paragraph 3.2.2) and *Willemsen Beheer v. NOM* (Supreme Court, 20 June 2008, ECLI:HR:2008:BC4959). In the latter case, a director applied for a moratorium without the approval of the general shareholders' meeting in order to isolate the company's major shareholder from further involvement.
46. Timmerman 2016, p. 324.

court's determination of liability. For this reason I included foreseeability of damage when it involved damage to the company or the company's creditors or shareholders.[47]

The contextual and behavioural legal case factors can be regarded as independent variables or predictor variables. Quantification for statistical analysis involved expressing these independent variables as a binary: 0 = the legal case factor did not occur in the case, 1 = the legal case factor occurred in the case. The case outcome to be predicted, whether a director was found personally liable (=1) or not found personally liable (=0), is regarded as the dependent variable.

3.3.4 Statistical analysis plan

Two important considerations in jurimetrics are sample size and the potential problem of over-determination. The sample size in this research cannot be said to be very large, especially given that it is used for the purpose of regression analysis.[48] I acknowledge that many rules of thumb exist with regard to sample size when undertaking multiple regression analysis. In the context of jurimetrics, it has been argued that the number of cases should be more than $2^{(u-1)}$, where u is the number of variables.[49] My data set complies with this criterion.[50] More importantly, several methods have been developed in legal scholarship to overcome the potential problem of over-determination. For instance, Nagel focused on a limited set of predictor variables for conducting a multiple regression analysis.[51] Haar et al. selected only highly significant variables.[52] Accordingly, I chose to apply logistic regression analysis on a limited set of factors – behavioural and contextual legal case factors – which I had derived from existing case law and subsequently only made use of the highly significant variables.[53]

47. See paragraph 3.2.5.
48. Combrink-Kuiters (1998, p. 3) argue that a small sample of carefully selected cases may be more representative of all possible cases than a large sample with a bias towards a particular group of cases.
49. Combrink-Kuiters 1998, p. 212.
50. As I have noted, the total sample size of this research involves 158 coded cases. The logistic regression analysis presented in Table 7 was conducted on the basis of 99 coded cases and 5 variables.
51. Nagel 1963.
52. Haar et al. 1977.
53. See also Givelber & Farrell 2008 p. 31-52.

Applying both bivariate and logistic regression analysis to the sample of court cases made it possible to determine which contextual and behavioural legal case factors may be important predictors of case outcome. Bivariate analysis provides insight into the independent effect of each of the predictor variables on directors' liability. Moreover, the bivariate analysis helps to identify which of the case factors are most relevant and best serve as important input for the logistic regression analysis.

To give due consideration to the 'all relevant circumstances' doctrine in established case law, the bivariate analysis was followed by a logistic regression analysis, a form of multiple regression analysis. In anticipation of the regression analysis, all legal case factors were tested for potential multicollinearity problems. The results did not give rise to concerns.[54] Implementing logistic regression analysis hierarchically enabled me to determine the effects of multiple legal case factors on the case outcome, i.e. the decision whether the director was or was not personally liable. Moreover, the effects of these legal case factors were compared in order to identify the most influential predictors and, concurrently, to assess if the factors identified in the simple legal decision model based on 'serious reproach' could be empirically grounded. Finally, the predictive value of each legal case factor was calculated in order to determine the consistency of legal decision-making. The court cases were analysed using IBM SPSS.[55]

54. See also footnote 59.
55. There are many books on methods of empirical legal research out there. I found the following very useful: A. Field, Discovering statistics using spss, Los Angeles, CA: Sage 2013; F. Pampel, *Logistic regression: A primer*, Sage University Papers Series on Quantitative Application in the Social Sciences, 07-132, Thousand Oaks, CA: Sage 2000, and R.M. Lawless, J.K. Robbennolt & T.S. Ulen, *Empirical methods in law*, New York: Aspen Publishers 2010.

3.4 Research results

3.4.1 Which behavioural and contextual legal case factors have a significant effect on directors' liability?

Table 1 shows the bivariate associations between the legal case factors under study and the outcome of a case. Pearson's chi-square test was used to investigate whether the relationships were statistically significant (sig. ≤ 0.05).[56] Cramér's statistics (V) was applied to obtain an idea of the strength of a potential association.[57]

Table 1. Bivariate associations between legal case factors and directors' liability (N=158)

Legal case factors	% Liability within categories[1]		Exact Sig. (2-sided)	Cramér's V
Behavioural factors:	1	0		
Unreasonably informed	58%	72%	.090	.146
Norm violation	89%	48%	.000	.428
Foreseeability of damage	96%	43%	.000	.545
Unreasonable risk taking	50%	72%	.010	.214
Incompetence[2]	–	–	–	–
Dereliction of duty	96%	60%	.000	.276
Conflict of interest	89%	58%	.000	.281

56. In standard English, 'significant' means important or relevant. In statistics 'significant' means probably true, not due to chance. A statistically significant result refers to a result that is not attributed to chance. Moreover, statistics is about probability, never 100% certainty. Whether there is a relationship between certain legal case factors under study and the outcome of a case (a director being found liable or not found liable) is only an estimate. Determining statistical significance therefore, practically, implies managing risk: can we live with a 10% likelihood that an outcome is wrong? A 5% likelihood? Or a 1% likelihood? In this research I adopted for a cutoff of 5%. In other words, I used a threshold for declaring statistical significance at a p-value of less than 0.05. For example, Table I shows, that in this study, there was no significant relationship between legal case factor 'unreasonably informed' and the case outcome (0.09 > 0.05).
57. A research finding may be statistically significant without being relevant: when a result is 'highly significant' it means that it might be true, it does not (necessarily) mean that it is relevant. I wanted to know the relevance of a legal case factor with respect to the case outcome. The Cramer's V test can be used to determine the strength of association between a legal case factor under review and the case outcome. The Cramer V thus gives additional information to say something about the importance or relevance of the association. Close to 0 it shows little association between the legal case factor and the case outcome; close to 1, it shows a strong, hence, relevant association. In this research, I assume a weak association at a level of $V < 0.3$; a medium strong association ($0.3 \leq V \leq 0.5$) and a strong association ($V > 0.5$).

Subjective bad faith	100%	45%	.000	.556
Limitation of liability	75%	55%	.012	.206
Contextual factors:	1	0		
Misrepresentation of information	95%	55%	.000	.373
Fraud	90%	60%	.001	.255
Policy failure	86%	63%	.048	.164
Mismanagement	95%	57%	.000	.335
Bankruptcy	66%	65%	1.000	.005

[1] These involve the percentages of cases in which the court judged a director personally liable under the condition that the legal case factor (predictor variable) occurred (=1) and did not occur (=0) in the cases under study.

[2] This legal case factor did not meet the requirements of the chi-square test (all expected counts are greater than 1, and no more than 20% of the expected counts is less than 5).

The research results show that there is a significant relationship between the factor of 'unreasonable risk taking' and the case outcome of a director being or not being found liable. The strength of the relationship is however weak ($V = 0.214$). The same can be said for the 'policy failure' factor ($V = 0.164$). These findings find support in case law, where directors are given discretion with regard to business judgement. The finding even suggest that courts ostensibly protect risk taking that prove (in hind sight) to have been excessive risk taking or business strategies that prove (in hind sight) to be failures. In other words, directors are actually unlikely to be deemed liable on the basis of these factors.

There is also a significant relationship between 'fraud' and case outcome, but the strength of this association is also weak ($V = 0.255$). A plausible explanation is that fraud, in the majority of observed cases, was not or not solely caused by the directors under review.

Of the legal case factors that were significantly correlated with the case outcome, two have a strong association ($V \geq 0.5$): 'foreseeability of damage' ($V = 0.545$) and 'subjective bad faith' ($V = 0.556$). I also found a medium strong association between 'norm violation' and case outcome ($0.3 \leq V \leq 0.5$). It is therefore not surprising that closer inspection of these three legal case factors reveals interesting observations.

Table 2. Crosstab legal case factor by directors' liability (N=158)

	Directors' liability			Exact Sig. (2-sided)
	Yes	*No*	*Total*	
Norm violation				.000
Yes	89%	11%	44%	
No	48%	52%	56%	
Foreseeability				.000
Yes	96%	4%	43%	
No	43%	57%	57%	
Subjective bad faith				.000
Yes	**100%**	**0%**	37%	
No	45%	55%	63%	

Table 2 shows that the director was found liable in 89% of the cases involving a 'norm violation'. In other words, in 11% of the cases involving a 'norm violation', the director under review managed to successfully advance circumstances in his defence to refute the claim.

Furthermore, 96% of the cases involving 'foreseeability of damage' on the part of the director, resulted in the director being held liable. This research result indicates that, whenever a court assumed that the damage to creditors was reasonably foreseeable, the chance of a director to successfully advance circumstances to refute the claim was very unlikely.

Strikingly, Table 2 reveals that directors were adjudged liable in all cases involving actions by the director in 'subjective bad faith'. The legal case factor of 'subjective bad faith' explains the case outcome (in one category) perfectly (100%). In other words, when a court determines that a director's action involves 'subjective bad faith', other factors seem irrelevant: the subjective bad faith action is alone sufficient to rule that a director is personally liable. Moreover, paragraph 3.3.4 raised the issue of whether there being problematic inter-correlations between the predictor variables used in this study. If, for example, inter-correlation exist between the factors of 'subjective bad faith' and 'foreseeability of damage', one of the factors might be redundant.[58] There were however no concerns with regard to multicollinearity. The factors 'subjective bad faith' and 'foreseeability of damage' seem to be relatively

58. O'Brien 2007, p. 673.

distinct, independent variables.[59] Because the sample of cases under study involved quite a large number of 'subjective bad faith' cases (one third of the sample involved 'subjective bad faith' actions on the part of the director), I wanted to understand this factor better. Consequently, I also examined the factor 'subjective bad faith' as a dependent variable.

3.4.2 Intermezzo: understanding subjective bad faith as a dependent variable

Assuming 'subjective bad faith' to be a dependent variable, it becomes important to determine which behavioural and contextual legal case factors influence the court's perception of a director's action in 'subjective bad faith'. Accordingly, I first applied bivariate analysis, the results of which are presented in Table 3.

Table 3. Bivariate associations between other legal case factors and director's 'subjective bad faith' (N=158)

Legal case factors	% subjective bad faith[1]		Exact Sig. (2-sided)	Cramér's V
***Behavioural factors*:**	1	0		
Unreasonably informed	22%	49%	.000	.284
Foreseeability of damage	66%	16%	.000	.518
Unreasonable risk taking	22%	44%	.011	.207
Incompetence[2]	–	–	–	–
Dereliction of duty	24%	40%	.177	.120
Conflict of interest[2]	–		–	–
Norm violation	47%	30%	.031	.181
Limitation of liability	33%	42%	.267	.088
***Contextual factors*:**	1	0		
Misrepresentation of information	55%	31%	.006	.217
Fraud	45%	35%	.408	.080
Policy failure	29%	39%	.471	.071
Mismanagement	32%	39%	.562	.056
Bankruptcy	35%	52%	.161	.127

59. A multicollinearity problem would exist if the predictor variables were moderately or highly correlated (inter-correlations between the predictor variables). For instance, if the factors 'bad faith' and 'foreseeability of damage' were highly correlated, it would means that there might be interference in determining the precise effect of each of the predictor variables on the case outcome. In the event of a multicollinearity problem, I would not be able to precisely determine in the subsequent regression analysis which of the predictor variables caused the case outcome.

[1] These involve the percentages of cases in which the court perceived a director's 'subjective bad faith' under the condition that the legal case factor (predictor variable) occurred (=1) and did not occur (=0) in the cases under study.
[2] This legal case factor did not meet the requirements of the chi-square test (all expected counts are greater than 1, and no more than 20% of the expected counts is less than 5).

Five legal case factors were found to have a significant effect on the court's perception of a director's action in 'subjective bad faith' (sig. ≤ 0.05). Of these 5 significant legal case factors, the factor 'foreseeability of damage' was found strongly associated with 'subjective bad faith' (V > 0.5). The other case factors were found weakly associated with 'subjective bad faith' (V < 0.3).

Further inspection shows that, in cases involving 'foreseeability of damage' on the part of the director, the court had affirmed that the director had acted in 'subjective bad faith' in 66% of them (Table 4).

Table 4. Crosstab foreseeability of damage by subjective bad faith (N=158)

	Subjective bad faith			Exact Sig. (2-sided)
	Yes	*No*	*Total*	
Foreseeability				.000
Yes	66%	34%	43%	
No	16%	84%	57%	

To understand 'subjective bad faith' as a dependent variable more thoroughly, a logistic regression was applied, the results of which are shown in Table 5. On the basis of the Wald statistic, it can be said that all but one case factor ('misrepresentation of information') make a significant contribution to the prediction of the outcome (sig. ≤ 0.05): namely, whether or not the court discerned 'subjective bad faith' on the part of the director. It is clear from Table 5 that 'foreseeability of damage' (Wald = 31.597) is the strongest predictor compared to the other predictor variables. Based on the odds ratio (Exp(B)), it can be said that a director's 'foreseeability of damage' leads to a court's perception of a director's 'subjective bad faith' with odds that are 14.70 times higher than in cases where there was no foreseeability of damage.

It is important to view these results with caution. In terms of effect size of the regression model, I obtained a Nagelkerke R square of 0.48. More broadly, the regression analysis was based on legal case factors. To understand 'subjective bad faith' in more depth requires further insight into 'simple' facts. In that respect, the model provides limited information.

Table 5. Logistic regression model: Subjective bad faith (N=158)

Legal case factors[1]	B	Wald[2]	Sig.	Exp(B)
***Behavioural factors*:**				
Foreseeability of damage	2.688	31.597	.000	14.699
Unreasonable information	-1.236	5.525	.019	.290
Norm violation	.907	4.012	.045	2.477
Unreasonable risk taking	-1.317	4.277	.039	.268
***Contextual factors*:**				
Misrepresentation of information	.849	2.632	.105	2.336
Constant	-1.736	16.540	.000	.176
Nagelkerke R square	0.484			
Overall accuracy of the model	77.2%			

[1] All legal case factors have been tested for multicollinearity. The results yield no concerns.
[2] The model was tested for robustness using the bootstrap method. The results do not give rise to different conclusions.

Based on the B-values in Table 5, it is possible to predict a hypothetical case with respect to a court's perception of a director's 'subjective bad faith'. The formula is presented below.

Formula 1:

$$P = \frac{1}{1+e^{-logit}}$$

$$\text{logit} = B_0 + B_1 * X_1 + B_2 * X_2 + .. + B_n * X_n$$

Interestingly, the factor 'foreseeability of damage' seems to be a primer for a court's perception of the director's 'subjective bad faith'. Applying Formula 1 to a hypothetical case involving 'foreseeability of damage' (and no other factors such as 'unreasonable information', 'unreasonable risk taking', 'misrepresentation of information', or 'norm violation' occurring in the case) yields a 72% chance that the court will attribute 'subjective bad faith' to a director:

$$\text{logit} = -1.736 + 2.688 * 1 - 1.236 * 0 + 0.907 * 0 - 1.317 * 0 + 0.849 * 0 = 0.952$$

$$P = \frac{1}{1+e^{-0.952}} \sim 0.72$$

Applying Formula 1 to a hypothetical case involving a 'norm violation' without the presence of other legal case factors results in a 30% chance that the court will attribute 'subjective bad faith' to a director.

The chance of discerning 'subjective bad faith' increases when more factors are in play, when there is, for example, 'foreseeability of damage' and the director 'violated a norm'. Applying Formula 1, there is an 87% chance of the court attributing 'subjective bad faith' to a director's action in such a case.

3.4.3 Which behavioural and contextual legal case factors have a significant effect on directors' liability in cases not involving directors' 'subjective bad faith'?

In paragraph 3.2.1, I discussed that, under established case law, courts are bound to apply an objective test when assessing if director conduct is subject to 'serious reproach'. By no means do Dutch courts require a claimant to prove a director's 'subjective bad faith'. Moreover, courts do not need to infer a director's 'subjective bad faith' to assume 'serious reproach' and find a director personally liable. It goes without saying that, when pleaded well, a director's 'subjective bad faith' action may influence a court's judgement. Consider for instance *De Rouw v. Dingemans* where a director acted fraudulently. The 'subjective bad faith' action on its own caused the court to assume that the director was personally liable, without regard to other factors. In paragraph 3.4.2, I demonstrated that, in 59 of the 158 sample cases, a director's 'subjective bad faith' action led a court to rule that a director bore personal liability. Moreover, I observed no variation in case outcome among the 59 'subjective bad faith' cases. This empirical finding bears an important consequence. Within the group of cases not involving director's 'subjective bad faith' (99 cases), I did observe variation in case outcome. To predict the outcome of these 99 cases not involving directors' 'subjective bad faith' requires a separate analysis of this group of cases.[60] To pursue this line of research, I conducted a bivariate analysis on the 99 cases *not* involving issues of 'subjective bad faith', the results of which are presented in Table 6.

60. The regression analysis based on the total sample of 158 cases did not reveal other significant legal case factors (see also Table 7 asterisk 2). This was presumably because one third of the sample (59 cases) was explainable as 'subjective bad faith'.

Table 6. Bivariate associations between behavioural and contextual legal case factors and directors' liability in cases not involving subjective bad faith (N=99)

Legal case factors	% Liability within categories[1]		Exact Sig. (2-sided)	Cramér's V
***Behavioural legal case factors*:**	1	0		
Unreasonably informed	46%	44%	1.000	.019
Norm violation	78%	26%	.000	.511
Foreseeability of damage	87%	33%	.000	.459
Unreasonable risk taking	36%	51%	.209	.142
Incompetence[2]	–	–	–	–
Dereliction of duty	95%	34%	.000	.482
Conflict of interest	69%	42%	.079	.186
Limitation of liability	63%	23%	.000	.391
***Contextual legal case factors*:**	1	0		
Misrepresentation of information	90%	35%	.000	.431
Fraud	82%	38%	.001	.337
Policy failure	80%	39%	.005	.293
Mismanagement	92%	30%	.000	.543
Bankruptcy	48%	27%	.336	.129

[1] These involve the percentages of cases in which the court judged a director personally liable under the condition that the legal case factor (predictor variable) occurred (=1) and did not occur (=0) in the cases under study.

[2] This legal case factor did not meet the requirement of the chi-square test (all expected counts are greater than 1 and no more than 20% of the expected counts is less than 5).

The research results indicate a strong association with directors' liability for 2 legal case factors ($V \geq 0.5$): 'mismanagement' ($V = 0.54$) and 'norm violation' ($V = 0.51$); and a medium strong association ($0.3 \leq V \leq 0.5$) for 5 legal case factors: 'dereliction of duty' ($V = 0.48$), 'foreseeability of damage' ($V = 0.46$), 'misrepresentation of information' ($V = 0.43$), 'limitation of liability' ($V = 0.39$) and 'fraud' ($V = 0.34$).

As I have explained in paragraph 3.3.4, bivariate analysis only provides insight into the independent effect of each of the predictor variables on directors' liability. It does not provide insight into how certain predictor variables relate to the case outcome as a group. The central focus of this research is to analyse the effect of multiple legal case factors on the case outcome (whether the director was deemed liable or not). Moreover, I wish to investigate whether

the factors of 'norm violation' and 'foreseeability of damage', which I identified as important factors in the court's simple legal decision model (paragraph 3.2.5), may find empirical support for their importance. The results are shown in Table 7.[61]

Table 7. Logistic regression model: Directors' liability (N=99)

Legal case factors[1]	**B**	**Wald**[2]	**Sig.**	**Exp(B)**
***Behavioural legal case factors*:**				
Foreseeability of damage	4.649	13.617	.000	104.480
Norm violation	4.096	12.808	.000	60.129
Dereliction of duty	-.550	.674	.412	.577
***Contextual legal case factors*:**				
Misrepresentation of information	4.123	8.576	.003	61.770
Mismanagement	3.695	8.226	.004	40.263
Constant	-3.106	4.263	.039	.045
Nagelkerke R square	0.80			
Overall accuracy of the model	88.9%			

[1] All legal case factors have been tested for multicollinearity. The results yield no concerns. The legal case factors have been analysed for potential interaction effects. The results do not give rise to different conclusions. At least, on the basis of this data set, potential interaction effects cannot be excluded.

[2] The model was tested for robustness using the bootstrap method. The results do not give rise to different conclusions. The model was also applied to the total sample of 158 cases. The results do not give rise to different conclusions.

All predictor variables are highly significant (sig. ≤ 0.05) except for 'dereliction of duty'. Analysing the predictor variables as a group shows that the legal case factors of 'foreseeability of damage' (Wald = 13.617) and 'norm violation' (Wald = 12.808) are the strongest predictors in the model in comparison to the other factors. In terms of effect size of the model, Nagelkerke R square of 0.80 was found and an overall prediction rate of 88.9%.[62] These research results indicate that the Supreme Court's simple legal decision model functions effectively. Courts apply the factors 'norm violation' and 'foreseeability of

61. I applied logistic regression analysis hierarchically to test several models. The Nagelkerke R square increased significantly when I tested the model involving the five predictor variables as presented in Table 7. The Nagelkerke R square ranges from 0 – 1 and indicates how well a model fits the data. I obtained a value of 0.8.
62. These results must be viewed with appropriate consideration of the following. I have used legal case factors: i.e. legally interpreted case factors occurring in a court decision. Consequently, these legal case factors by their character, are very close to the outcome of a court case. This may explain in part the high predictive value of the model obtained in Table 7.

damage' fairly consistently. Arguably, there is empirical support for the conclusion that these two predictor variables are the most influential legal case factors adjudicating directors' liability.

Based on the B-values in Table 7, it is now possible to predict the outcome of a hypothetical case. Let us imagine that in a given case there was 'mismanagement' – for instance, the company's administrative system was failing – and that the director acted in conflict with a norm ('norm violation') and other factors did not occur. Applying Formula 1, there is a 99% chance that the case would end with the director bearing personal liability.[63]

Table 8 presents several more hypothetical cases. The chance of finding a director liable increases when more legal case factors are considered.

Table 8. Chance of a director being held personally liable based on prediction model

Legal case factors	Case 1	Case 2	Case 3	Case 4	Case 5
Foreseeability of damage	–	X	X	–	–
Norm violation	X	X	–	X	–
Dereliction of duty	–	–	–	–	–
Misrepresentation of information	–	–	–	–	X
Mismanagement	X	–	–	–	–
Chance of directors' liability	99%	99%	82%	73%	73%

3.5 Discussion

3.5.1 Interpreting the research results

In interpreting the research results, it is important to first recognise that I did not differentiate the statistical analysis in terms of the different forms of directors' liability. In addition, it is necessary to keep in mind that the prediction model in Table 7 was constructed on the basis of cases that had been isolated from those involving directors' actions carried out in 'subjective bad faith'.

63. $\text{logit} = -3.106 + 4.649 * 0 + 4.096 * 1 - 0.550 * 0 + 4.123 * 0 + 3.695 * 1 = 4.685$

$$P = \frac{1}{1+e^{-4.685}} \sim 0.99.$$

3.5.1.1 Directors' 'subjective bad faith'

One striking empirical finding of this research is the large number of 'subjective bad faith' cases (59 of the 158 coded cases). These 'subjective bad faith' cases involve the court's perception of directors' actions with the intent to do harm to the company or company's stakeholders. I attempted to determine which of the legal case factors could be of predictive value to a court's assumption of director's 'subjective bad faith'. The research results presented in Table 5 (Logistic regression model: Subjective bad faith) indicate that a director's 'foreseeability of damage' is a prime indicator for the assumption of a director's 'subjective bad faith'. Based on the regression model, there is a 72% chance that when 'foreseeability of damage' is at issue in a court case without mention of other case factors, the court tends to assume that there was 'subjective bad faith' on the part of the director (see paragraph 3.4.2). I have noted that these results must be viewed with caution. The effect size of the model was not very high. Further, I based the regression analysis on legal case factors. It goes without saying that a more thorough understanding of 'subjective bad faith' would require insight into 'simple' facts, which are likely to provide more information.[64]

Apart from the results obtained from the regression analysis, it is important to note that, when a court is convinced of a director's 'subjective bad faith', other circumstances seem to become irrelevant, or at least seem not to influence a court's decision. This finding may therefore be helpful for future legal decision-makers, justifying the stipulation of an explicit 'zero tolerance policy' with regard to behaviours involving 'subjective bad faith'. Moreover, this finding suggests that future legal decision-making may benefit from a judicial distinction between 'subjective bad faith' cases and cases 'not involving subjective bad faith'. It is only in the latter cases that variation in circumstances (other than 'subjective bad faith') may cause changes in case outcome.

In accordance with the foregoing, the dominant role played by 'subjective bad faith' led me to extend and refine the quantitative research by focusing on the analysis of the sample of cases not involving 'subjective bad faith' (N=99). The results obtained are discussed below.

64. The same would apply to all other legal case factors that were the object of this study. The more a case factor is legally interpreted, the more the raw information is absolved.

3.5.1.2 'Foreseeability of damage' and 'norm violation'

As noted above, courts tend to use a simple legal decision model to assess directors' liability. Based on the legal analysis (paragraph 3.2), I assumed that, within a simplified legal decision model, a court will likely judge a director personally liable in the event of 'norm violation' or 'foreseeable damage'. My research reveals that such a practice has empirical support. Applying logistic regression to the sample of cases not involving 'subjective bad faith' (N=99), I found that the factors of 'foreseeability of damage' and 'norm violation' were the two most influential predictor variables.

The model indicates that if a director violates a norm that was specifically addressed to him or her or if a director acts despite being aware of 'foreseeable damage', the court will generally find the director liable. 'Foreseeability of damage' is identified as the most influential case factor. This result is interesting for three reasons. First, despite the finding of a statistical significant relationship between 'foreseeable damage' and 'subjective bad faith' (see paragraph 3.5.1), 'foreseeability of damage' and 'subjective bad faith' should be regarded as two distinct factors in their relationship to case outcome.[65] 'Foreseeability of damage' does not require 'subjective bad faith' and 'subjective bad faith' cannot be equated to 'foreseeability of damage'. Hence, based on this research, the factor 'foreseeability of damage' yields a distinctive predictive value with regards to case outcome.

Second, the Wald statistic indicates that the influence of 'foreseeability of damage' on case outcome is stronger than the influence of 'norm violation' (Table 7). Applying Formula 1, there is an 82% chance that the assumption of 'foreseeability of damage' will result in a director being held liable, compared to a 73% chance in cases involving a 'norm violation' (disregarding other factors in the case). This research result may suggest that when a court discerns 'norm violation', a director enjoys more scope to refute his or her liability than in cases where 'foreseeability of damage' is established.

Third, from a legal point of view, 'foreseeability of damage' plays a central role in determining external directors' liability, while its role in determining internal directors' liability or liability in bankruptcy remains less explicit. This point was also emphasised by Assink et al.[66] Empirically, I observed that when 'foreseeable damage' does occur in the context of a 2:9 or 2:138/248 DCC claim, it strongly influences the case outcome, making it more likely

65. See the discussion in paragraph 3.4.1
66. Assink et al. 2011, p. 3.

for the director to be found liable. Moreover, claimants may successfully bring multiple claims and/or base their claims on more than one legal ground. A good example was provided in *Ceteco*[67] where the trustee in bankruptcy successfully based the liability claim on art. 2:9, 6:162 and 2:138 DCC. For example, it was judged that the directors had violated internal rules and that the damage to the company was foreseeable in the face of an aggressive acquisition policy and inadequate internal management.

3.5.1.3 Contextual legal case factors

The research results in Table 7 further demonstrate that case factors of 'mismanagement' (Wald = 8.226) and 'misrepresentation of information' (Wald = 8.576) yield a significant effect (sig. < 0.05) but contribute less to case outcome compared to the other factors in the model. The finding suggests that courts seek to distinguish company liability from the personal liability of the director concerned. Nevertheless, when 'misrepresentation of information' occurs in a hypothetical case and other factors do not occur, it yields a 73% chance of a director being found liable.

Finally, the observation that 'dereliction of duty' was not a significant factor may be explained by the fact that the frequency of this factor in the cases subjected to analysis was very low.

3.5.1.4 Legal case factors that did not occur in the prediction model

The absence of some other legal case factors from the logistic regression model in Table 7 is equally interesting, in light of those that did appear. In particular, the factors of 'policy failure' and 'bankruptcy' as well as 'unreasonably informed', 'unreasonable risk taking' and 'incompetence',[68] were found not to have significant effects on the court's determination of directors' liability. These findings may suggest that directors enjoy substantive discretion under the framework of 'serious reproach', and, moreover, that judges take a more reserved approach to risk taking with its associated potential damage to the company and/or third parties of that company. When it comes to risk taking and directors' competence, it seems that courts are inclined to give the director the benefit of the doubt, providing the director did not act in 'subjective bad faith'. I observed that 'unreasonable risk taking' was at issue in 46 of the 158 sample cases. This factor on its own may not be problematic; it may not cause a court to assume a director's personal liability. Only in 13

67. District Court Utrecht, 12 December 2007, ECLI:NL:RBUTR:2007:BB9709 (*Ceteco*).
68. Noting that the observation of 'incompetence' was very low.

cases did the court judge the director personally liable, in the absence of directors' 'subjective bad faith'. In these 13 cases not involving 'subjective bad faith', the director was adjudged liable based on a combination of legal case factors including 'unreasonable risk taking'. This seems consistent with *Staleman v. Van de Ven*, in which case the court reasoned that the directors exposed the company to excessive risks *and* had violated internal norms.

Further, I observed directors' 'incompetence' in only 11 of the 158 cases. In 6 cases the court judged the director personally liable in the absence of directors' 'subjective bad faith'. Again, I observed that the factor 'incompetence' on its own did not result in a director's personal liability. In the 6 cases not involving 'subjective bad faith', liability was based on a combination of other legal case factors, such as 'mismanagement', 'norm violation' and 'foreseeable damage'. An example is provided by *Ceteco*, where the court considered a range of different factors, including the directors' ignorance about the company's risks and failure to control the company's internal and administrative organisation.

3.5.2 Quality of the regression model

I have demonstrated that it is possible to empirically analyse the manner in which courts reach decisions. I have tried to model legal decision-making in a complex and unstructured legal environment. However, legal modelling only makes sense if the model is valid from multiple perspectives and does not merely provide a mathematical formula to predict court decisions.[69] After all, courts do not apply mathematics to determine a director's personal liability.

3.5.2.1 Reliability

Several statistical strategies and tests have been applied to ensure the quality of the regression model obtained in Table 7. I have discussed these issues at length in the statistical analysis plan (paragraph 3.3.4). Considerations concerning the reliability of the model should take the following into account. First, courts may also implicitly include legal or non-legal facts in their assessment that are not referred to in the text of a decision and are therefore not considered in this research. Second, the sample itself may have contributed to the high predictive value of the model. I used only cases involving a judgment about a director's personal liability. Moreover, only legal case factors were the object of statistical analysis. Furthermore, the cases selected for this study were rendered between 2003 and 2013, during which time case law underwent considerable development by means of influential land mark

69. Combrink-Kuiters & Piepers, 1994.

cases. The outcome of the selected cases had the added benefit of having being influenced by several of these land mark cases.[70] Finally, most directors' liability cases may be unproblematic or quite simple, allowing judges to produce 'automated' decisions.

3.5.2.2 Internal validity

The logistic regression model involving directors' liability was analysed for residuals. SPSS identified three outliers.[71] I discovered an interesting pattern. The outliers involved cases which did not score on one of the factors in the model (Table 7), but nevertheless involved determination of directors' liability. To protect the data from being distorted by the outliers, I applied bootstrapping. It has been argued that bootstrapping is a very suitable validation method.[72] Bootstrapping follows the idea of pooling but, by repeatedly resampling the data, it studies the uncertainty in the frequency estimate obtained.[73] By resampling with replacement from the original sample, SPSS created one thousand alternate versions of the data set and in that way reduced the impact of the outliers. The aim of the bootstrapping was therefore to enhance the stability and reliability of the model by using the entire data set for validation purposes.[74] I used the method for both regression models: 'subjective bad faith' and 'directors' liability'. In my case, after bootstrapping (with 95% percentile confidence interval), the models remained stable and did not lead to different conclusions.

3.5.2.3 External validity

It must be recognised that the prediction model developed in this study is based on a data set involving a selection of court cases from 2003 to 2013. I have not exposed the prediction model to a different external sample. In the current analysis, my intention was not to generalise the observed cases to all possible directors' liability cases. Additional studies showing similar results are needed in order to be more confident that the obtained prediction rates prove to be stable. It is therefore problematic to generalise the findings of this study to other sets of cases in the past or in the future.

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70. E.g. *Staleman v. Van de Ven* (1997): *Panmo I* and *Panmo II* (2001); *Schwandt v. Berghuizer Papierfabriek* (2002); *Ontvanger v. Roelofsen* (2006); *Blue Tomato* (2007); *Willemsen Beheer v. NOM* (2008); *Kloosterbrink v. Eurocommerce* (2009).
71. Hawkins 1980, p. 1.
72. Osborne & Overbay 2004, p. 4
73. Wright et al. 2011, p. 252-270.
74. Wright 2011; Efron & Tibshirani 1993.

Moreover, I have not dealt with the question of how courts assess the extent to which 'foreseeability of damage' is apparent to a director. Case law only instructs an objective test, disregarding material conditions that may lead to a court's finding that damage was foreseeable to a director. The model would gain more importance if there was a better understanding of the conditions under which the courts made such determinations.

Finally, Table 7 only recognises those factors that appear to have a bearing on the determination of directors' liability in cases not involving subjective bad faith. I did not address the question of why these factors are important for reaching court decisions in such cases. The model would gain in significance if the 'why' could be answered to a sufficient extent. This however requires a normative validation.

3.6 Concluding remarks & further research

I have demonstrated that it is possible to construct a simple model to determine directors' liability. An integration of qualitative and quantitative methods proved to be successful and may be applicable to different legal domains where judges make decisions on the basis of open norms and contextual circumstances. The robustness and high predictive value of the model deserves further exploration. Future research should first determine factors that lead to a court's assumption that a director was able to foresee damage. Second, the model should be validated by differentiating the statistical analysis of theoretically distinct forms of directors' liability. Third, the fundamental question of what justifies the assessment of directors' liability based on the factors obtained in this research should be explored. The answer to this question requires a normative study. Chiefly, the present research identifies influential predictor variables without engaging in a normative assessment of the legal reasoning in the legal domain of directors' liability.

APPENDIX I

Dependent variable	
Court decision	1=director liable 0=director not liable *Observations:* N=158: 1=66%, 0=34% N=99: 1=45%, 0=55%
Independent variable	
Behavioural legal case factors	1=occurring in case 0=not occurring in case
Unreasonably informed Whether a director did not attempt to be reasonably informed.	N=158: 1=44%, 0=56% N=99: 1=55%, 0=45%
Norm violation Whether a director violated statutory norms (art. 2:138/248[2] DCC) or internal norms specifically addressed to him meant to protect the (stakeholders of) the company.	N=158: 1=44%, 0=56% N=99: 1=37%, 2=63%
Foreseeability of damage Whether a director could have reasonably foreseen damage to the company or the company's creditors or shareholders.	N=158: 1=43%, 0=57% N=99, 1=23%, 0=77%
Unreasonable risk taking Whether a director failed to sufficiently investigate certain risks or took excessive risks.	N=158: 1=29%, 0=71% N=99: 1=36%, 0=64%
Incompetence Whether a director was not competent for the tasks assigned to him or her as a director.	N=158: 1=7%, 0=93% N=99: 1=7%, 0=93%
Dereliction of duty Whether a director disregarded duties despite a known duty to act.	N=158: 1=16%, 0=84% N=99: 1=19%, 0=81%
Conflict of interest Whether a director had a conflict of interest in the meaning of art. 2:129/239(6) DCC.	N=158: 1=24%, 0=76% N=99: 1=13%, 0=87%
Subjective bad faith Whether a director acted with the intent to do harm to the (stakeholders of the) company (including fraud, forgery, unjust enrichment, manipulating or concealing (financial) data or other relevant information, carrying out actions for personal benefit	N=158: 1=37%, 0=63%

while disregarding the interests of the company or company's stakeholders).	
Limitation of liability Whether a director invoked discharge, allocation of duties within the board of directors or statutory exculpation (in the meaning of art. 2:9[2] or 2:138/248[3] DCC).	N=158: 1=53%, 0=47% N=99: 1=57%, 0=43%
Contextual legal case factors	
Misrepresentation of information Whether a company misrepresented information by providing inaccurate or incomplete information.	N=158, 1=27%, 0=73% N=99: 1=19%, 0=81%
Fraud Whether corporate fraud occurred.	N=158, 1=20%, 0=80% N=99: 1=17%, 0=83%
Policy failure Whether a company's strategy failed.	N=158, 1=13%, 0=87% N=99: 1=15%, 0=85%
Mismanagement Whether a company's internal management was incorrect or insufficient.	N=158, 1=23%, 0=77% N=99, 1=25%, 0=75%
Bankruptcy Whether a company entered bankruptcy.	N=158, 1=85%, 0=15% N=99, 1=89%, 0=11%
All observations have been presented in rounded percentages.	

Other factors	
Type of legal dispute on which adjudication was based:	
– Art. 2:9 DCC	N=158: 20%, N=99: 19%
– Art. 6:162 DCC	N=158: 45%, N=99: 40%
– Art. 2:138/248 DCC	N=158: 35%, N=99: 41%
Type of court:	
– District court	N=158: 56%, N=99: 55%
– Court of appeal	N=158: 37%, N=99: 40%
– Supreme court	N=158: 6%, N=99: 5%
Type of governance:	
– Sole director	N=158: 35%, N=99: 33%
– One-tier board	N=158: 44%, N=99: 41%
– Two-tier board	N=158: 15%, N=99: 15%
– Unknown	N=158: 7%, N=99: 10%
Decision OK Whether there was a decision of the Enterprise Chamber (OK) of the Court of Appeal of Amsterdam of mismanagement [wanbeleid].	N=158: 1=8%, unknown: 92% N=99: 1=5%, unknown: 95%
Capacity defendant:	
– Management board	N=158: 27%, N=99: 28%
– Supervisory board	N=158: 4%, N=99: 6%

– Individual executive director	N=158: 30%, N=99: 28%
– Individual non-executive director	N=158: 1%, N=99: 2%
– Sole director	N=158: 29%, N=99: 24%
– De facto director	N=158: 10%, N=99: 11%
Capacity claimant:	
– Company	N=158: 12%, N=99: 10%
– Creditor	N=158: 37%, N=99: 35%
– Trustee in bankruptcy	N=158: 47%, N=99: 52%
– Shareholder	N=158: 4%, N=99: 3%
All observations have been presented in rounded percentages.	

APPENDIX II

Sample of court decisions

ECLI:NL:RBMNE:2013:CA3225

ECLI:NL:GHDHA:2013:1024

ECLI:NL:GHDHA:2013:624

ECLI:NL:RBONE:2013:2837

ECLI:NL:GHAMS:2013:CA1778

ECLI:NL:GHARL:2013:CA1206

ECLI:NL:GHSHE:2012:BY7042

ECLI:NL:RBDOR:2012:BY7080

ECLI:NL:GHSGR:2012:BY6142

ECLI:NL:GHAMS:2012:BX8923

ECLI:NL:RBSHE:2012:BW8973

ECLI:NL:RBAMS:2012:BW3790

ECLI:NL:GHLEE:2012:BW2950

ECLI:NL:RBSGR:2012:BW2957

ECLI:NL:RBUTR:2012:BV3753

ECLI:NL:GHAMS:2012:BZ0122

ECLI:NL:RBROT:2012:BY5066

ECLI:NL:GHAMS:2012:BX1192

ECLI:NL:RBHAA:2011:6088

ECLI:NL:GHARN:2011:BV0325

ECLI:RBUTR:2011:BU4413

ECLI:NL:RBSHE:2011:BU8193

ECLI:NL:RBROT:2011:BR7071

ECLI:NL:GHARN:2011:BR3465

ECLI:NL:RBHAA:2011:6136

ECLI:NL:RBMAA:2011:BR0410

ECLI:NL:RBASS:2011:BT8742

ECLI:NL:RBUTR:2011:BQ7136

ECLI:NL:RBSG:2011:BQ6042

ECLI:NL:GHARN:2011:BQ0581

ECLI:NL:RBAMS:2011:BP2561

ECLI:NL:GHSHE:2011:BU9066

ECLI:NL:RBROT:2010:BN7874

ECLI:NL:HR:2011:BP1408

ECLI:NL:HR:2010:BM2332

ECLI:NL:GHAMS:2010:BQ1193

ECLI:NL:GHAMS:2010:BN6929

ECLI:NL:GHARN:2010:BN0711

ECLI:NL:RBUTR:2010:BL8927

ECLI:NL:RBMID:2010:BM8669

ECLI:NL:HR:2010:BK9654

ECLI:NL:GHAMS:2010:BM9466

ECLI:NL:RBDOR:2010:BL3691

ECLI:NL:RBUTR:2010:4232

ECLI:NL:GHAMS:2010:BO0956

ECLI:NL:RBSHE:2010:5764

ECLI:NL:RBROT:2010:BL4366

ECLI:NL:GHSHE:2010:BL2154

Court of Appeal Arnhem, 30 March 2010, number 200.013.591

ECLI:NL:GHSHE:2009:BK7951

ECLI:NL:RBAMS:2009:BP3270

ECLI:NL:RBAMS:2009:BK7176

ECLI:NL:RBDOR:2009:BL4364

ECLI:NL:RBUTR:2009:BK3016

ECLI:NL:GHSHE:2009:BK5887

ECLI:NL:RBHAA:2009:BJ6988

ECLI:NL:HR:2009:BI0468

ECLI:NL:RBROT:2009:BI7381

ECLI:RBDOR:2009:BI1819

ECLI:NL:RBARN:2009:BI0060

ECLI:NL:HR:2009:BG6445

District Court Utrecht, 28 November 2009, number HA ZA 09-466

Court of Appeal Amsterdam, 17 November 2009, number 106.007.293/01

District Court Arnhem, 13 May 2009, number HA ZA 08-516

ECLI:RBROT:2008:BG8104

ECLI:NL:GHARN:2008:BH2625

ECLI:NL:GHSGR:2008:BG3451

ECLI:NL:RBUTR:2008:BD8730

ECLI:NL:GHLEE:2008:BF2830

ECLI:NL:HR:2008:BC8416

ECLI:NL:RBARN:2008:BD1784

ECLI:NL:RBAMS:2008:BC8599

ECLI:GHLEE:2008:BC3428

Court of Appeal Amsterdam, 9 December 2008, number 106.005.566

Court of Appeal ’s-Hertogenbosch, 22 April 2008, number HD 103.003.538

District Court Middelburg, 19 March 2008, number HA ZA 06-213

Court of Appeal Amsterdam, 19 February 2008, number 104.004.771

ECLI:NL:GHSHE:2007:BC1129

ECLI:NL:GHAMS:2007:BD4223

ECLI:NL:RBDOR:2007:BB9557

ECLI:NL:RBAMS:2007:BC1308

ECLI:NL:GHARN:2007:BC4583

ECLI:NL:RBSGR:2007:BD1415

ECLI:NL:RBROT:2007:BM6301

ECLI:NL:RBAMS:2007:BA4517

District Court Rotterdam, 7 November 2007, number HA ZA 07-132

Court of Appeal 's-Gravenhage, 26 September 2006, number 00/691

Court of Appeal Amsterdam, 29 March 2007, number 1135/04

ECLI:NL:HR:2006:AZ0758

ECLI:NL:HR:2006:AY9710

ECLI:NL:RBROT:2006:AZ8542

ECLI:NL:GHSGR:2006:AZ5068

ECLI:NL:GHLEE:2006:AY6866

ECLI:NL:GHLEE:2006:AX6252

Court of Appeal, 27 April 2006, number 2004/1317

Court of Appeal, 9 March 2006, number 1503/02

ECLI:NL:RBAMS:2005:AZ1989

ECLI:NL:HR:2005:AS5103

ECLI:NL:RBARN:2005:AT6337

Court of Appeal 's-Gravenhage, 17 February 2005, number C98/00747

Court of Appeal Arnhem, 8 February 2005, number 2004/536

ECLI:RBHAA:2004:AS6732

ECLI:NL:GHLEE:2004:AR3937

ECLI:NL:GHSHE:2004:AS5955

ECLI:NL:GHSHE:2004:AQ5636

ECLI:NL:GHSHE:2004:AR1234

ECLI:NL:RBZWO:2004:AO9014

District Court Almelo, 20 October 2004, number HA ZA 1040

Court of Appeal ’s-Hertogenbosch, 13 July 2004, number C9701012

ECLI:RBROE:2003:3097

Court of Appeal Amsterdam, 18 December 2003, number C03/99112

District Court Alkmaar, 27 August 2003, number HA ZA 02-652

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Case law

Supreme Court:

Supreme Court, 12 February 2016, ECLI:NL:HR:2016:233.

Supreme Court, 27 February 2015, ECLI:NL:HR:22015:499 (*ING v. BTO*), conclusion A-G Timmerman, 21 November 2014, ECLI:NL:PHR:2014:2242.

Supreme Court, 5 September 2014, ECLI:HR:2014:2627 (*RCI Financial Services v. Kastrop*).

Supreme Court, 9 May 2014, ECLI:NL:HR:2014:2628 (*Hezemans Air v. Van der Meer*).

Supreme Court, 4 April 2014, ECLI:NL:HR:2014:829 (*X v. Ingwersen*).

Supreme Court, 1 November 2013, ECLI:NL:HR:2013:1079 (*Verify*).

Supreme Court, 8 July 2011, ECLI:NL:HR:2011:BP8686 (*Interust v. Ontvanger*).

Supreme Court, 11 February 2011, ECLI:NL:HR:2011:BO9577 (*Nilarco*).

Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).

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Supreme Court, 20 June 2008, ECLI:HR:2008:BC4959 (*Willemsen Beheer v. NOM*).

Supreme Court, 30 November 2007, ECLI:NL:HR:2007:BA6773 (*Blue Tomato*).

Supreme Court, 2 March 2007, ECLI:NL:HR:2007:AZ3535, conclusion A-G Timmerman, 2 March 2007, ECLI:NL:PHR:2007:AZ3535 (*Westland v. Schieke*).

Supreme Court, 8 December 2006, ECLI:NL:HR:2006:AZ0758, conclusion A-G Timmerman, 8 December 2006, ECLI:NL:PHR:2006:AZ0758 (*Ontvanger v. Roelofsen*).

Supreme Court, 29 November 2002, ECLI:NL:HR:2002:AE701 (*Schwandt v. Berghuizer Papierfabriek*).

Supreme Court, 8 June 2001, ECLI:NL:HR:2001:AB2053 (*Panmo I*) and ECLI:NL:HR:2001:AB2021 (*Panmo II*).

Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243, *NJ* 1997, 360 with case note J.M.M. Maeijer (*Staleman v. Van de Ven*).

Supreme Court, 6 October 1989, ECLI:NL:HR:1989:AB9521, *NJ* 1990, 286, with case note J.M.M. Maeijer (*Beklamel*).

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Court of Appeal Arnhem, 20 December 2011, ECLI:NL:GHARN:2011:BV0325 (*Broekmans Beheer v. BRR Participaties*).

Court of Appeal Leeuwarden, 30 January 2008, ECLI:NL:GHLEE:2008:BC3428 (*Bokma Reclamebureau B.V.*).

Court of Appeal ’s-Gravenhage, 23 September 2008, ECLI:NL:GHSGR:2008:BF1833 (*Lébol Kittechnieken B.V.*).

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Chapter 4. Rethinking discharge from directors' liability. *Using comparative and empirical insights*

4.1 Introduction

The focus of the previous chapter was on the most relevant legal case factors on which courts base their legal decisions in directors' liability litigation. The cases included in the study could, it might be argued, be divided into relatively 'unproblematic cases' and more 'complex cases'. The unproblematic cases involved cases in which a director's 'subjective bad faith' was predominantly evident. In these relatively unproblematic cases, the directors were deemed to be personally liable. The outcomes of the 'complex cases' in the study were less straightforward and could involve either a confirmation of a director's personal liability or a dismissal of the claim. Complex cases in which courts find directors to be personally liable may be understood to indicate that the directors apparently 'lacked good faith'. Complex cases where courts refuse to hold a director personally liable may be interpreted as reaffirming the 'good faith' underlying the director's conduct (see Chapter 3, Figure 1).

The object of this Chapter 4 is to analyse court cases involving directors who are deemed to act in 'bad faith' (i.e. directors displaying 'subjective bad faith' and 'lack of good faith') but who also invoke discharge provisions. In these specific court cases, directors rely on the protection of a discharge in an attempt to avoid their personal liability for 'bad faith' actions. The study reveals that courts are unwilling to allow discharge by means of a shareholders' resolution to cover such 'bad faith' actions.

This research was conducted in 2015.

4.1.1 Research issue: understanding a waiver of rights in the light of good corporate governance

Whenever it is suspected that a director's fear of personal liability may have adverse consequences, a waiver of rights may offer one potential legal means to mitigate the director's undesirable risk-aversion by reducing the exposure

to liability.[1] At the same time, waivers may not be unlimited and disarm the deterrent function of personal liability. Good corporate governance thus demands that directors' personal liability and liability limitation are well-balanced.[2] In Chapter 2, I emphasised the important role that courts may play in maintaining this balance. In Chapter 3, I examined the concrete factors that may guide courts in deciding when to relieve a director of personal liability and when to hold a director personally liable.

The empirical finding in Chapter 3 further showed that there was no single case in which a director was not held liable for an action in 'subjective bad faith'. Evidently, Dutch courts require directors to act in 'good faith'. The findings stand in stark contrast to existing legal doctrine on the 'limited scope of discharge' [de beperkte reikwijdte van de décharge], which suggests that a director may be discharged of personal liability to the company when acting in 'subjective bad faith' as long as these litigious actions were 'known actions', which is to say that they were disclosed to the company's shareholders.[3]

The focus of this research is therefore to investigate the apparent problematic issue of discharge from directors' liability to a company for actions performed in 'subjective bad faith' and to explore new points of view which may improve the Dutch practice of discharge as part of good corporate governance. To sharpen the analysis, I studied court decisions involving discharge provisions and distinguished them into those in which a director's action involved 'subjective bad faith' and those involving a 'lack of good faith'. As the findings in Chapter 3 indicate, either type of bad faith action or, better said, the difference in the serious reproachable conduct does not seem to have played a role in the outcome of the specific court cases included in this study. Courts were unwilling to absolve directors of personal liability to the company under a discharge provision in both types of case. I was interested in understanding why.

Indeed, it was my suspicion that the existing doctrine on the Dutch practice of discharge may not contribute to good corporate governance as it does not require directors' 'good faith' as a precondition. The empirical and comparative insights in this research may help to further develop the practice and provide new points of view to rethink the role of discharge in terms of good corporate governance.

1. Pham 2014, p. 20-27; Herzel, Shepro, & Katz 1987, p. 38-43; Kaplan & Harrison 1993, p. 412-432.
2. See also paragraphs 1.1.3 and 2.6.
3. Dutch Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*); Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*); Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).

4.1.2 Research question

In this research, I begin by assuming that the existing legal doctrine on the 'limited scope of discharge' may be problematic. The existing doctrine seems not to require directors to act in 'good faith' as a precondition to discharging them of any personal liability to the company. This seems to be at odds with empirical findings and the notions underlying good corporate governance, which should require directors to act in 'good faith' in the interest of the company.

The central question in this research is therefore as follows: why is it problematic that the existing legal doctrine on the 'limited scope of discharge' does not mention the 'good faith' of directors as a requirement for their discharge from personal liability to the company? And which new points of view may improve the practices involving the Dutch notion of discharge?

4.1.3 Comparative and empirical insights

To explore the research question, I made use of comparative and empirical insights. Although discharge has been subjected to considerable scholarly writing in the Netherlands, most of this scholarship has focused on the legal scope of the instrument,[4] while the concept of discharge as a corporate governance instrument has remained relatively unchartered.[5] This is, at the very least, remarkable. The Netherlands is a unique jurisdiction where derivative actions are not possible[6] and the litigation rate is quite moderate.[7] It furthermore differs from other European jurisdictions, as it has adopted a relatively far-reaching discharge provision. Compared to other European countries, the Dutch concept of discharge seems relatively unconditional. As long as any litigious action is 'known' to the general shareholders' meeting at the time of discharge, as evidenced by information provided in the financial statements or other information made available to the shareholders' meeting, a shareholders' discharge resolution may shield directors from liability claims arising from serious

4. Among others, Klaassen 2008, p. 184-187; Bier 2006, p. 37-48; De Jong 2001, p. 232-239; De Kluiver 1997, p. 373-378; Beckman 1994, p. 113-117.
5. As one of the few who did, Van Wijk (2011, p. 123-128) made a connection between discharge and the interests of the company.
6. In a comparative study conducted by Manifest, Unanyants-Jackson (2008) reported that, of the 13 European countries under study, derivative actions were not possible in Luxembourg and the Netherlands. The 13 European countries involved were: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Luxembourg, the Netherlands, Portugal, Spain, Sweden and Switzerland.
7. Blankenburg 1998, p. 1-41. See also Chapter 3, Figure 2 of this book in which I show a weak increase in the number of findings for directors' liability.

reproachable conduct, including intentional harmful conduct.[8] It is important to note that the requirement of 'known' action to insulate directors from liability for 'bad faith' actions is not codified but was developed in Dutch case law.[9]

To the extent that one believes, as I do, that directors' liability legislation has a deterrent value or serves to induce directors to act prudently and thoughtfully, the logic of 'known' action as the basis for a discharge from even 'bad faith' actions is problematic. First, this practice increases the importance of discharge as a corporate governance instrument.[10] Second, the adoption of any such resolution is a hypothetical exercise rather than an actual activity compelling a Dutch court to apply the discharge and exempt a director from liability for 'bad faith' actions. Upholding the myth that Dutch courts will insulate directors from personal liability to the company when he or she acts in bad faith adds confusion and complexity. Third and broader, good corporate governance may not well served by finding it acceptable to shield directors from personal liability to a company when they act in bad faith even if the shareholders' meeting carried knowledge of these bad faith actions.

4.1.3.1 Delaware as a source of inspiration

Notwithstanding any discharge from liability granted by the general shareholders' meeting on the basis of the existing legal doctrine, I observed empirically that it is very unlikely that Dutch courts will release directors from any liability to the company when they fail to act in 'good faith'.[11] However, Dutch courts do not explicitly use the term 'good faith' to distinguish 'bona fide directors'

8. The Manifest study indicates that in any other European country under study a shareholders' discharge resolution is similarly based on information provided in the annual report or other documents made available to shareholders and informing them on potential breaches of duties or norms for which a director desires to be discharged (Unanyants-Jackson 2008, p. 8). The scope of the limitation of liability may vary in the different jurisdictions however. For instance, in Sweden and Switzerland, a director may be discharged of wilful misconduct, but not unconditionally. Section 33, Chapter 9 of the Swedish Companies Act requires a discharge to be submitted at each annual general shareholders' meeting. Moreover, the Act requires the auditor's report to contain a statement indicating whether members of the board should be granted discharge from liability to the company. Under Swiss law, discharge of wilful misconduct only legally applies to those shareholders who gave their consent to the resolution or who subsequently acquired shares with knowledge of the resolution (Unanyants-Jackson 2008, p. 35). Further, the effect of the discharge is mitigated by excluding persons who participated in the management of the company (including de facto directors) from voting on the discharge resolution, including persons acting as a proxy for another shareholder (p. 36). For a more comprehensive comparative overview, see E. Smerdon (ed.) 2001.
9. Supreme Court, 20 June 1924, *NJ* 1924, 1107 (*Truffino*) and Supreme Court, 17 June 1921, *NJ* 1921, 737 (*Deen v. Perlak*).
10. Abma 2014, p. 217-232.
11. See Chapter 3, Figure 1.

from those who are not. Only the latter category of directors is more likely to be held personally liable regardless of any discharge. This empirical finding has led me to use Delaware (case) law, specifically section 102(b)(7) of Delaware General Corporation Law (DGCL), as a source of inspiration. Delaware's exculpatory provision as codified in section 102(b)(7) DGCL explicitly employs the term 'good faith' to distinguish 'bona fide directors' from those who should not be afforded the protection of an exculpatory charter provision. The 'good faith' of directors constitutes a baseline. In the absence of malicious intent, Delaware directors may effectively rely on their company's exculpatory charter provisions to shield them from potential personal liabilities.[12] Furthermore, directors' liability litigation is more severe in Delaware; hence the function and rationale of section 102(b)(7) has been tested frequently. Importantly, Delaware courts review exculpatory claims in the light of corporate governance and director duties. The above-mentioned points make Delaware case law involving section 102(b)(7) an interesting study object for this research.

Still, it must be recognised that using section 102(b)(7) and its case law as comparative material involves some caveats. I will limit myself to discussing the three most important difficulties. First, exculpatory provisions in the certificates of incorporation of most Delaware corporations subject to section 102 (b)(7) DGCL protecting directors – not officers[13] – from monetary claims for breaches of fiduciary care apply to derivative claims. Such legal instruments which allow shareholders to instigate legal action in the name and on behalf of the company for alleged violation of fiduciary duties, do not exist in the Netherlands.[14] The Dutch discharge applies to supervisory directors and executive directors in the context of internal directors' liability. Under Dutch company law, the company itself is the proper authority to instigate a claim when it incurs damage due to a director's action.[15]

Second, the question of whether a director can be held liable under Delaware's legal framework is dependent on the fiduciary duty that has been allegedly breached (care or loyalty) and the test that a Delaware court employs to review the conduct at issue (the business judgement rule, the heightened standards

12. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006).
13. A Delaware corporation typically features a one-tier board of directors generally comprising the CEO and CFO and outside directors (directors not involved in the daily management of the corporation). Contextual circumstances may sufficiently support the inference that the corporation's CEO and/or CFO act in the capacity of officers and as such cannot rely on the protection of section 102(b)(7) DGCL (see for example *Chen v. Howard-Anderson*, 87 A.3d 648 [Del. Ch. 2014]).
14. See Kroeze (2004, p. 183) for a comprehensive overview of derivative action, the arguments in favour of implementing derivative action in the Netherlands (p. 341) and the important distinction between derivative and direct action (p.195).
15. Dutch Supreme Court, 2 December 1994, ECLI:NL:HR:2007:AZ0419, par. 3.4.1 (*Poot v. ABP*).

of review or the entire fairness standard).[16] Section 102(b)(7) DCC enables Delaware companies to exempt directors from liability for monetary damages arising out of duty-of-care claims.[17] If, in other words, a director breaches his or her duty of loyalty (of which good faith forms an element), the director cannot rely on the protection provided by section 102(b)(7) as the charter provision excludes coverage for conduct that is disloyal.[18] If, however, a claimant only asserts a duty-of-care claim, section 102(b)(7) may be properly invoked and may form the basis for dismissing the claim. Even where a claimant is able to rebut the business judgment presumption in the complaint 'solely by successfully alleging a duty of care violation', a director may properly invoke the exculpatory provision and block a trial on the issue of entire fairness, as section 102(b)(7) will exculpate a director defendant from paying monetary damages.[19] In contrast, Dutch law does not make doctrinal distinction between directors' duties of care and loyalty. Instead, art. 2:9 DCC prescribes a general norm of 'proper performance of duties'. Consequently, it is quite alien to the Dutch legal system to exclude a director from liability for monetary damages regarding specific director duties owed to the company.

Third, section 102(b)(7) is an enabling provision, allowing companies to insert the protective shield into the companies' articles of association and, in so doing, give directors the benefit of ex-ante protection against potential liability risks.[20] Section 102(b)(7) DGCL is considered to represent and to carry out an important public policy purpose of 'encouraging capable persons to serve as directors of corporations by providing them with the freedom to make risky, good faith business decisions without fear of personal liability.'[21] Providing directors ex-ante protection has, it is argued, the benefit of preventing directors from being distracted, shirking their duties or even refusing to accept

16. See Assink 2007 (providing a comprehensive overview of fiduciary duties in Delaware and judicial review on the basis of the business judgement rule, the heightened standards of review and the entire fairness standard).
17. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006).
18. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006). See also *Guttman v. Huang* 823 A.2d 492 (Del. Ch. 2003).
19. *Emerald Partners v. Berlin*, 726 A.2d 85 (Del. 2001) ('If a shareholder complaint unambiguously asserts only a due care claim, the complaint is dismissible once the corporation's Section 102(b)(7) provision is properly invoked (…) Consequently, a trial pursuant to the entire fairness standard of review would serve no useful purpose. Thus, under those specific circumstances, when the presumption of the business judgment rule has been rebutted in the shareholder complaint solely by successfully alleging a duty of care violation, the director defendants do not have to prove entire fairness to the trier of facts, because of the exculpation afforded to the directors by the Section 102(b)(7) provision inserted by the shareholders into the corporation's charter.').
20. Section 102(b)(7) DGCL is deemed to represent and to carry out an important public policy purpose of encouraging board service.
21. *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 17 November 2004).

board positions out of fear of personal liability.[22] The Dutch discharge has, in contrast , been justified as an instrument which typically is provided ex-post, closely connected to the approval of the financial statements [periodieke décharge] or to the resignation of a director [finale décharge]. The retrospective element of the discharge may therefore be one important explanation why Dutch courts require knowledge by the general shareholders' meeting of potential litigious actions to allow a discharge to have legal effect.

Recognising the considerable difficulties that arise when comparing Delaware's section 102(b)(7) with the Dutch concept of discharge, I found the empirical findings obtained in the previous Chapter 3 nonetheless sufficiently persuasive. It is my assumption in this research that, in both legal systems, discharge and exculpation, effectively function as a waiver of rights: a voluntarily relinquishment of the legal right of a company to claim monetary damages from its director in connection with potential directors' liability. If the waiver is valid and is properly invoked, the waiver may function to protect a director against personal liability to the company and exempt a director from paying monetary damages. Moreover, supported by the aforementioned empirical finding, it is my assumption that, in both legal systems, Dutch and Delaware courts implicitly or explicitly use 'good faith' as a lens through which they review discharge or exculpatory claims.

4.1.3.2 Looking at discharge claims empirically using Dutch court cases (2003-2013)

This empirical part of the research is based on a sample of court cases involving discharge claims from 1 January 2003 to 1 September 2013 and is in fact based on the original sample used for the purpose of the research in Chapter 3.[23]

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22. See also Assink & Slagter 2013, p. 1162 (distinguishing between the incentives that retrospective and prospective instruments may create and arguing that prospective instruments may be beneficial to a bona fide director who, relying on these instruments, may optimise his skills and knowledge in order to maximise the company's value with the least possible distraction by personal legal repercussions for potentially failing strategies).
23. See paragraph 3.3.2 for the details on case characteristics and selection. Again I followed the same procedure as I did for the research in Chapter 3. All court decision were checked on 'rechtspraak.nl' to acquire the most recent decision in which a court ruled on directors' liability or dismissed the claim in connection with discharge. I found one case in which one of the parties had appealed and used this judgement instead: Court of Appeal Arnhem-Leeuwarden, 23 April 2013, ECLI:NL:GHARL:2013:CA1206 CA1206 (*Traffic Service Nederland B.V.*).

I have mentioned that, whenever Dutch courts judge that a director had acted in 'bad faith', they also likely find a director personally liable. In this part of the research, I will deepen the research by focussing on the relation between directors' invocation of discharge and the decisoin of the court. I intend to observe if and how a discharge provision can effectively protect directors against personal liability to the company. For this reason, only court decisions involving an assessment of a director's personal liability are utilised.

I coded 11 cases for the analysis.[24] To be able to observe if the discharge provision could succesfully shield a director from personal liability to the company and if so, how and for which litigious actions, I first constructed the pattern of legal reasoning which I assume courts use to review appeals to discharge provisions. The pattern of legal reasoning is predominantly based on several landmark cases and is presented in paragraph 4.3.1.[25] Moreover, I aimed to indentify cases in which directors' 'bad faith' was at issue and to understand how courts have coped with these cases. Finally, reference will be made to comparitive insights in order to consider whether the existing legal doctrine of the 'limited scope of discharge' is in need of improvement and, if so, whether requiring directors' 'good faith' as a baseline for discharge could be of added value.

4.2 Delaware exculpatory provision

4.2.1 Section 102(b)(7) DGCL: framework

Section 102(b)(7) DGCL enables Delaware companies to include exculpatory provisions in their certificates of incorporation in order to potentially eliminate or limit the personal liability of a director to the company and/or its shareholders for monetary damages due to breach of fiduciary duty as a director (but not as an officer).[26] Even if a company adopts the most protective charter provision possible, the law expressly prohibits exculpation for certain categories of impermissible conduct:

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24. The cases are presented in paragraph 4.3.2, Table 9.
25. Dutch Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*); Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*); Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
26. I would like to emphasise here that, although monetary damage claims based on violations of duty of care may be barred pursuant to section 102(b)(7) DGCL, the exculpatory provision does not eliminate a director's fiduciary duty of care. A court may still grant injunctive relief for violations of the duty of care. Section 102(b)(7) DGCL serves only to withdraw one remedy for a breach of that duty of care. Nonetheless, the bulk of litigation involves claims for monetary damages.

1. Liability for any breach of the director's duty of loyalty to the corporation or its shareholders;
2. Liability for acts or omissions not in good faith or which involve intentional misconduct or knowing violation of law;
3. Liability under Section 174 DGCL (liability for the payment of unlawful dividends or unlawful share purchases or redemptions);
4. Liability for any transaction from which a director derived an improper personal benefit.

Under Delaware's legal framework, directors owe the company fiduciary duties of care and loyalty.[27] Existing case law determines that directors can only be exculpated from duty of care claims.[28] The list of claims above may therefore be regarded as a list of duty of loyalty claims, which are non-exculpable claims under section 102(b)(7).[29]

There has been considerable litigation involving what constitutes non-exculpable claims. In particular, the disputed issues concern the ways in which 'good faith' is related to a director's' duty of loyalty. In the seminal case *Stone v. Ritter*, the Delaware Supreme Court decided that 'good faith' forms a condition of the duty of loyalty:

> 'The failure to act in good faith may result in liability because the requirement to act in good faith "is a subsidiary element," i.e. a condition, "of the fundamental duty of loyalty." It follows that because a showing of bad faith conduct, in the sense described in *Disney* and *Caremark*, is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty. This view of a failure to act in good faith results in two additional doctrinal consequences. First, although good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith

27. The Delaware Supreme Court has, on occasion, referred to directors' fiduciary duties as a triad of duties involving care, loyalty and good faith (for instance *Emerald Partners v. Berlin*, 787 A. 2d 85 (Del. 2001), par. 90.
28. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006); *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006).
29. For illustration, see *Guttman v. Huang* 823 A.2d 492 (Del. Ch. 2003), par. 506 ('The General Assembly could contribute usefully to ending the balkanization of the duty of loyalty by rewriting § 102(b)(7) to make clear that its subparts all illustrate conduct that is disloyal.').

> may do so, but indirectly. The second doctrinal consequence is that the fiduciary duty of loyalty is not limited to cases involving a financial or other recognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith. As the Court of Chancery aptly put it in *Guttman*, "a director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest".'[30]

Stone v. Ritter thus clarifies that violations of the duty of loyalty may not only arise in the context of conflicts of interests but may also arise from a failure to act in 'good faith'. Moreover, as 'good faith' forms a prerequisite for directors' loyalty, a failure to act in 'good faith' constitute a violation of the fiduciary duty of loyalty. Hence, any director whose actions lack 'good faith' breaches the fiduciary duty of loyalty and cannot rely on the protection of section 102(b)(7) DGCL. Accordingly, *Stone v. Ritter* leads me to understand 'good faith' as an important determinant of a director's loyalty. If shareholders allege sufficient facts to allow the inference that a director's action was 'not in good faith', the director concerned may not be protected under section 102(b)(7) DGCL.

The importance of a director's 'good faith' is consequently best understood by referring to the Delaware's exculpatory provision in section 102(b)(7). The provision was enacted in the late eighties against the background of changes in the liability environment. In the following paragraph, I will provide some empirical insights to contextualise the rationale and purpose of section 102(b)(7) DGCL.

4.2.2 Empirical insights

Many legal writings attribute the origin of section 102(b)(7) DGCL to *Smith v. Van Gorkom*.[31] The case involved a proposed leveraged buy-out merger of TransUnion by the Marmon Group. Van Gorkom, TransUnion's chairman and CEO, proposed a share price that would facilitate a leveraged buy-out but did not represent the per share intrinsic value of the company. The proposed merger was subjected to board approval. The Delaware Supreme Court found that the directors were grossly negligent because the merger was, in the absence of an emergency situation, promptly approved without substantial inquiry or any expert advice. For this reason, the board of directors breached their duty of care to the company's shareholders and could not be protected under the business judgment rule.

30. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), par. 370.
31. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

It has been suggested in the literature that the controversial landmark case fuelled the liability crisis.[32] The case prompted an outcry from boards of directors and a sharp increase in insurance premiums for directors' and officers' liability insurance (D&O).[33] Many legal writers cited *Van Gorkom* to explain why Delaware subsequently adopted section 102(b)(7).[34] While there was a time when actions by shareholders or other parties were rare, Trieschmann and Leverett noted in 1990 that companies now should 'better protect their directors and officers from the increasing amount of litigation.'[35] Trieschmann and Leverett based their argument on a survey conducted by The Wyatt Company in 1988. According to this survey, there were 24 D&O claims among the companies surveyed in 1975 as opposed to 157 claims in 1988. 'An increase of more than 500 percent in 13 years.'[36] Furthermore, 'stockholders represent the major source of all claims', accounting for 35 to 50 percent as opposed to third-party claims, accounting for 35 to 45 percent of the claims.[37] Based on an empirical study of shareholder derivative and class action lawsuits between 1970 and 1979, Jones identified that the largest part of shareholder actions in the late 1970s related to securities disclosures and insider trading, followed by merger related actions, charges of self-dealing and illegal acts.[38] To bring these lawsuits into perspective, the study showed that shareholder litigation was highly concentrated in a few companies. Furthermore, the vast majority of corporate executives seemed to have had no direct experience with shareholder litigation. Relatively few companies carried the burden of the claims. Only 13 companies (less than 6.8% of the total) were involved in more than four lawsuits; 171 companies were involved in one or less (91.6%); and 69.5% experienced none at all.[39] Large companies were more likely to be involved in multiple actions because they had more shareholders to account for and because these companies were unable to resolve the claims at a pace equal with the rate at which the claims were being filed.[40] Jones' trend analysis further showed that the group of companies studied tended to have hardly any more lawsuits each year than in the previous year. Indeed, legal risks due to shareholder litigation was argued to be 'neither great nor growing at a significant rate.'[41]

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32. Kaplan & Harrison 1993, p. 419-420.
33. Perkins 1986, p. 8-14; Romano 1988, p. 67-80.
34. Among the few authors, Norwicki (2007, p. 478) contested the established belief that *Smith v. Van Gorkom* had such an effect on the insurance crisis that the 'fear of the potential director pool drying up' could be a valid argument for adopting section 102(b)(7).
35. Trieschmann & Leverett Jr. 1990, p. 52.
36. Trieschmann & Leverett Jr. 1990, p. 52.
37. Trieschmann & Leverett Jr. 1990, p. 52.
38. Jones 1981, p. 81-82.
39. Jones 1981, p. 78-79.
40. Jones, 1981, p. 80.
41. Jones instead insisted that executives should be worried by insurance firms that press larger and costlier liability policies on them than by liability risks (Jones 1981, p. 80).

Assuming that litigation risks have since been growing, a more recent study involving external director out-of-pocket liability from between 1968 to 2005 conducted by Black, Cheffins and Klausner found only four cases in which external directors were found liable. With respect to these cases, the researchers found only two instances where the director suffered out-of-pocket liability.[42] As with Jones' study, the researchers also found that shareholder lawsuits were the largest source of risk. Roughly 3000 shareholder suits have been filed in U.S. federal courts since 1990, yet only four of these suits have gone to trial, none of which involved external directors. The claimant won in only one instance, as the researchers reported.[43] Clearly, directors' fear of personal liability is not based on the actual liability exposure but on the perceived liability exposure.[44] Moreover, Black, Cheffins and Klausner argued that some characteristics of the U.S. legal system may amplify directors' fear of personal liability. The researchers raised three factors which may encourage litigation. First, litigants pay their own legal expenses regardless of the outcome of a case. In other words, a claimant bringing a marginal case does not have to worry about paying the defendant's expenses in the event the claim is dismissed. Second, derivative litigation rules allow any shareholder to bring proceedings against a director on behalf of the company. Third, a claimant's attorney is typically seen as an 'entrepreneur', aggressively seeking legal violations and prospective clients rather than waiting passively for a prospective claimant to knock on the door. These incentives may explain the volume of claims that have been instigated in contrast with the very low number of claims that actually reached a court for trial.

Against the backdrop of the changing liability environment for American directors and the typical characteristics of the US legal system, the exculpatory provision should be seen foremost as a barrier to frivolous litigation. As can be learned from case law, exculpatory clauses prove their best value when courts allow director defendants to use the clause to terminate litigation by motion early in the proceeding. Accordingly, if a director defendant can raise the clause in a motion to dismiss, the lawsuit can be terminated before beginning discovery and public purview.[45]

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42. Black, Cheffins & Klausner 2005, p. 158, Table 2.
43. Black, Cheffins & Klausner 2005, p. 157.
44. Pham 2014, p. 27.
45. As Kapnick and Rosen (2010, p. 4) noted, 'neither should [practitioners and courts, TP] be reluctant to rely on exculpatory clauses as the basis for an early dismissal'.

4.2.3 Section 102(b)(7) DGCL as a device to dismiss claims

As has been discussed in the previous paragraph, the important objective of the exculpatory provision is to reduce the exposure of directors to liability. One strategy in this regard involves pre-trial dismissal of ill-founded complaints on the basis of Rule 12(b)(6) of the Federal Rules of Civil Procedure (FRCP).[46] A claim against a director risks dismissal if the complainant fails to sufficiently argue that the director's conduct falls into at least one of the exceptions under which a director is not afforded the protection of the exculpatory provision (see paragraph 4.2.1).[47] For instance, the Delaware Supreme court ruled in *Emerald v. Partners* that section 102(b)(7) DGCL must be seen as an affirmative defence and explicitly noted that pre-trial dismissal is still proper when only due care claims are pleaded or claimants failed to rebut the presumptions of the business judgment rule.[48] It was made clear in *Malpiede v. Townson*, however, that dismissal is still justified when a claimant pleads a duty of loyalty claim if the complaint fails to include any adequate allegation of a

46. Section 102(b)(7) may also be employed in motions to dismiss derivative lawsuits for failure to make demand under Rule 21.1 of the Delaware Rules of Civil Procedure. See *Wood v. Baum*, 953 A.2d 136 (Del. 2008), par. 141 (holding that when courts adjudicate the sufficiency of allegations of demand futility, they should take exculpatory clauses into account. In this case, there were no particular allegations that the directors had 'actual or constructive knowledge' about the illegality of their conduct). See also *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), par. 372-373. A motion to dismiss based on futility grounds was also raised in *Disney*, but could not waylay the doubts raised in the complaint as to whether the board's actions were taken honestly and in good faith, as required under Rule 21.1 (*In re Walt Disney Company Derivative Litigation*, 825 A.2d 275 (Del. Ch. 2003), par. 286. I will leave further discussion of Rule 21.1 outside the scope of this research and would like to limit myself to note that, under Delaware law, shareholders are permitted to bring a derivative action if they satisfy several requirements. One important procedural barrier is that there has been harm to the corporation but the board of directors has not taken measures against the wrongdoers. Accordingly, eligible shareholders must first file a demand for the board to take action. See Kroeze 2004 p. 208-215 (discussing the rationale of the requirement of the demand for board action).
47. In a case involving a merger, the Chancery Court decided that, where a 'shareholder failed to make any allegations in the complaint that the special committee engaged in any conduct that would not be exculpated by the company's 102(b)(7) charter provision', the complaint must be dismissed (*Direinzo v. Lichtenstein*, 2013 Del. Ch. Lexis 242 (Del. Ch. Sept. 30, 2013).
48. *Emerald Partners v. Berlin*, 726 A.2d 85 (Del. 2001), par. 92. Note that section 102(b)(7) is only at the disposal of Delaware's directors, not officers. Courts may dismiss complaints pursuant to Rule 12(b)(7) based on the business judgement rule or section 102(b)(7), unless material facts raise doubts as to the directors' good faith and necessitates judicial review at trial.

breach of a duty of loyalty.[49] Material details seem to be important. For instance, an allegation that the defendant-directors instructed an insolvent company to pay excessive compensation to themselves did not duly support a duty of loyalty claim if the complaint omits to state the amount of the allegedly excessive compensation or indicate which directors approved the compensation.[50] The fact remains however that claimants strategically find ways to 'plead around' the statute by raising issues of facts with respect to the various elements of the statute in the attempt to survive motions to dismiss and to press for credible settlement leverage.

The recent Delaware Supreme Court decision in *In re Cornerstone Therapeutics* is promising insofar as it underlines the legislative purpose of exculpatory clauses to mitigate claims. The Court formulated a general rule: 'A plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct – be it Revlon, Unocal, the entire fairness standard, or the business judgment rule.'[51] In *Cornerstone,* the company's minority shareholders brought actions against the directors arising out of transactions in which the controlling shareholder acquired the remaining shares. The independent directors of the company filed motions to dismiss the action by invoking the company's exculpatory charter provision. The court ruled that the claimants were 'not entitled to an automatic inference that a director facilitating an interested transaction is disloyal.' A mere allegation that a disinterested director facilitated a transaction with a controlling shareholder that was not entirely fair was insufficient to survive dismissal.[52] Accordingly, *Cornerstone* indicates that, in spite of the judicial review at issue, claimants remain compelled to plead non-exculpated claims against each of the defendant directors in order to survive dismissal of the claim.[53] In *Cornerstone*, the court required at the very least, that

49. 'The plaintiffs are entitled to all reasonable inferences flowing from their pleadings, but if those inferences do not support a valid legal claim, the complaint should be dismissed without the need for the defendants to file an answer and without proceeding with discovery. Here we have assumed, without deciding, that the amended complaint on its face states a due care claim. Because we have determined that the complaint fails properly to invoke loyalty and bad faith claims, we are left with only a due care claim' (*Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001), par. 1094.
50. *Nelson v. Emerson*, 2008 Del. Ch. Lexis 56 (Del. Ch. May 6, 2008).
51. *In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1176.
52. *In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1181.
53. *In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1182. The importance of pleading a non-exculpated claim was also critical in *Americas Mining Corp. v. Theriault*, 51 A. 3d 1213 (Del. 2012). The derivative suit first filed in 2004 involved a merger between Southern Peru and Americas Mining Corporation and was reviewed under the entire fairness test. At a hearing held on 21 December 2010, the Court of Chancery dismissed the

the facts create an inference that a director acted out of self-interest, adverse to the stockholders' interests or acted in bad faith.[54]

It is clear now that, under Delaware law, where a corporate transaction was made by a controlling shareholder standing on both sides of the transaction, the controlling shareholder bears the burden of proving the entire fairness of the transaction. Disinterested directors with no financial stake in the transaction may be liable for breach of fiduciary duty only when they have breached a non-exculpated duty in connection with the negotiation or approval of the transaction. Moreover, as *Cornerstone* has shown, the fact that the liability of disinterested directors depends on a non-exculpated breach of duty makes it necessary for claimants to allege sufficient facts at the motion to dismiss stage to support an inference of a non-exculpated breach.[55] The ruling in *Cornerstone* could not be more clear and precise in demonstrating that the purpose of section

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Special Committee defendants from the case, because the claimant had failed to present evidence supporting a non-exculpated breach of their fiduciary duty of loyalty. The remaining defendants had a self-dealing interest directly in conflict with Southern Peru. The exculpatory clause could not benefit them. Moreover, at trial, these director defendants did not make efforts to show that they acted in good faith and were entitled to exculpation despite their lack of independence. On 27 August 2012, the Supreme Court affirmed the Chancery Court's decision awarding damages of more than $2 billion and $304 million in attorneys' fees. It was determined and affirmed that the controlling shareholder defendants breached their fiduciary duty of loyalty in a transaction involving the controlling shareholder's subsidiary. The transaction failed the entire fairness standard of review. Southern Peru overpaid more than $1 billion when it acquired the controlling shareholder's subsidiary.

54. 'When a corporate director is protected by an exculpatory charter provision, a plaintiff can survive a motion to dismiss by that director defendant, by pleading facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith; but the mere fact that a plaintiff is able to plead facts supporting the application of the entire fairness standard to the transaction, and can thus state a duty of loyalty claim against the interested fiduciaries, does not relieve the plaintiff of the responsibility to plead a non-exculpated claim against each director who moves for dismissal' (*In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1180). See *In re Alloy*, A.3d 2011 Del. Ch. Lexis 159 (Del. Ch. Oct. 13, 2011) in which the Chancery Court also required facts to support an inference that the alleged disclosure violations were 'the product of anything other than good faith omissions' by the directors who authorised them. And *In Re Novell*, A.3d, 2013. Del. Ch. Lexis (Del.Ch. Jan. 3, 2013).

55. The requirements posed on the claimants' complaint was rationalised as follows: 'As is well understood, the fear that directors who faced personal liability for potentially value-maximizing business decisions might be dissuaded from making such decisions is why Section 102(b)(7) was adopted in the first place (...) The purpose of Section 102(b)(7) was to "free[ ] up directors to take business risks without worrying about negligence lawsuits." Establishing a rule that all directors must remain as parties in litigation involving a transaction with a controlling stockholder would thus reduce the benefits that the General Assembly anticipated in adopting Section 102(b)(7) (*In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1185).

102(b)(7) DGCL is to reduce directors' liability risks by formulating a rule for dismissing 'ill-founded' monetary claims.

4.2.4 Section 102(b)(7) DGCL as an affirmative defence

The recent *Cornerstone* decision underlines that it is appropriate to allow 102 (b)(7) defences to be asserted at the motion to dismiss stage. To allow cases to go forward, shareholders-claimants are required to satisfy a pleading standard: if a complaint unambiguously alleges only a breach of the duty of care, the exculpatory clause may be properly applied to allow early dismissal.[56] However, only when the complaint alleges a breach of the duty of loyalty, and the complaint cites specific facts, rather than mere allegations, an exculpatory clause will not warrant early dismissal.[57] In the latter well-pleaded cases, section 102(b)(7) continues to carry its legal implication as an affirmative defence.[58] To understand the function of an affirmative defence, it is important to review *Emerald Partners v. Berlin*[59] in order to discern appropriate guidelines.

In this seminal case, the claimant alleged that the director defendants committed waste by approving a transfer of assets to a fellow director (the CEO) in order to secure that director's personal loans while providing the company with little or no consideration in return. The claimant was successful in rebutting the business judgement presumption and the burden of proof shifted to the directors to demonstrate that the transaction was entirely fair to the claimant. The defendants invoked the exculpatory provision. At trial, the Delaware Supreme Court had to decide when it is procedurally appropriate to consider the substantive effect of a section 102(b)(7) provision invoked by the directors pursuant to the entire fairness standard of judicial review. The Delaware Supreme Court first characterised the Delaware limited liability statute as an affirmative defence.[60] As the court held, an affirmative defence is "[a] defendant's assertion raising new facts and arguments that, if true, will defeat the claimant's claim, even if all allegations in the complaint are true." In other words, a 102(b)(7) provision functions not to defeat the validity of a claimant's claim on the merits, but may

56. *Malpiede v. Townson*, 780 A.2d 1075, 1094 (Del. 2001).
57. *Emerald Partners v. Berlin* 787 A.2d 85 (Del. 1999), par. 92 and *In re Cornerstone Therapeutics,* 115 A.3d 1173 (Del. 2015), par. 1180.
58. See also *Alidina v. Internet.com Corp*. 2002 Del.Ch. Lexis 156 (Del. Ch. Nov. 6, 2002), par. 28, holding that 'when a duty of care breach is not the exclusive claim, (…) the § 102 (b)(7) provision cannot operate to negate plaintiffs' duty of care claim on a motion to dismiss.'
59. *Emerald Partners v. Berlin* 787 A.2d 85 (Del. 1999).
60. *Emerald Partners v. Berlin* 787 A.2d 85 (Del. 1999), par. 92.

defeat the claimant's ability to recover monetary damages. The application of the defence is fact-based and the defendant directors have the burden of proof regarding those issues of fact. In its analysis, the court reasoned that, where the entire fairness standard is applicable, 'injury or damages becomes a proper focus only after a transaction is determined not to be entirely fair.'[61] And thus, the exculpatory effect of a section 102(b)(7) provision becomes the subject of judicial scrutiny after the directors' potential personal liability has been established.[62] Accordingly, when a transaction requires an entire fairness review, a section 102(b)(7) charter provision cannot eliminate an entire fairness analysis by the court. In the post-trial decision on remand, the Chancery Court reviewed and confirmed the affirmative defences. The central issue of review on remand was whether the defendants' conduct involved a violation of the duty of loyalty or of care. As in the earlier Delaware Supreme Court decision, the defendants can be exculpated only if the unfairness in the merger was found to have resulted 'solely from a violation of the duty of care.' The Chancery Court ultimately decided that the merger was in fact entirely fair and, even if it were unfair, the 'unfairness could only have been the sole result of a breach of the defendants' duty of care for which the directors were exculpated from monetary liability due to the exculpatory clauses.'[63]

4.2.5 No liability protection for 'subjective bad faith' or 'not in good faith' actions

As already mentioned, directors owe the company fiduciary duties of care and loyalty. Delaware courts determine whether the directors' actions have met the standard of conduct imposed by their fiduciary obligations through the lens of a standard of review: the business judgement rule, the heightened standards of review (Revlon and Unocal) or the entire fairness standard. Exculpatory

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61. *Emerald Partners v. Berlin* 787 A.2d 85 (Del. 1999), par. 93.
62. *Emerald Partners v. Berlin* 787 A.2d 85 (Del. 1999), par. 93. The reasoning in *Emerald* was later applied by both federal and state courts. For instance *Ad Hoc Comm. of Equity Holders of Tectonic Network, Inc. v. Wolford*, 554 F. Supp. 2d 538 (D. Del. 2008); *In re Direct Response Media, Inc.*, 2012 Bankr. Lexis 41 (Bankr. D. Del. Jan. 12, 2012) (involving allegations of fraudulent transfers); *In re Orchard Enterprises, Inc. stockholder litigation*, 88 A.3d 1 (Del. Ch. Jan. 9, 2014) (involving a merger in which Dimensional squeezed out the minority stockholders of Orchard). The claimants contended that the merger was not entirely fair and that Dimensional and the directors who approved the merger breached their duty of loyalty. The Chancery Court concluded that 'the award of damages can only be determined after trial holding that, 'when a case involves a controlling stockholder with entire fairness as the standard of review, and when there is evidence of procedural and substantive unfairness, a court cannot summarily apply Section 102(b)(7) on a motion for summary judgment to dismiss facially independent and disinterested directors.' And citing *Emerald*, "Under those circumstances, it is not possible to hold as a matter of law that the factual basis for [the] claim *solely* implicates a violation of the duty of care."
63. *Emerald Partners v. Berlin*, A.2d, 2003 WL 21003437 (Del. Ch., Apr. 28, 2003, par. 38 and 42.

clauses may be raised, indifferently to the underlying standard of review, and this either at the earliest procedural stage or at trial, as *Cornerstone* and *Emerald* shows (see paragraphs 4.2.3. and 4.2.4 respectively). Only when a shareholder-claimant is able to successfully allege a non-exculpated claim under section 102(b)(7) – a claim implicating a breach of the duty of loyalty – would a director find himself in the danger zone. As I have discussed in paragraph 4.2.1, 'good faith' is an important condition of a director's loyalty.[64] If shareholders allege sufficient facts to support an inference that the directors' actions were 'not in good faith', the directors concerned may not be protected under section 102(b)(7) DGCL. In this paragraph, I will explore the delicate distinction between 'subjective bad faith' actions, actions 'not in good faith' and actions 'in good faith' by making use of the Delaware Supreme Court's decisions in *Disney* and *Stone*.

Disney[65] was an important turning point. In reviewing whether Disney's directors lacked good faith with regards to Ovitz' employment and severance pay-out, the Delaware Supreme Court undertook to define categories of conduct which may constitute directors' 'bad faith'. Three categories of potential bad faith actions were construed. The first, 'subjective bad faith' involves actions motivated by an 'actual intent to do harm.' The second, actions taken 'solely by reason of gross negligence and without any malevolent intent' do not constitute bad faith but 'lack of due care', for which the director may be exculpated. The third, actions 'not motivated by subjective bad intent' but still 'qualitatively more culpable than gross negligence' are in bad faith insofar as they manifest an 'intentional dereliction of duty, a conscious disregard for one's responsibilities.'[66] The first category of misconduct evidently constitutes a breach of loyalty and thus involves a non-exculpatory claim under section 102(b)(7). The second category of misconduct may only constitute a breach of due care for which the director may be exculpated. The third category of misconduct, which in *Disney* was distinctively qualified 'not in good faith', constitutes a breach of loyalty for which section 102(b)(7) expressly denies exculpation from monetary damages.

It is interesting to note that, in *Disney*, the Court qualified 'intentional misconduct' and a 'knowing violation of law' as actions involving 'subjective bad faith', whereas 'intentional dereliction of duty, a conscious disregard for one's responsibilities' was behaviour performed 'not in good faith'.[67] It goes without saying that for both misbehaviours, the duty of loyalty is violated and thus, under these conditions, a director cannot rely on the exculpatory provision of 102(b)(7).

64. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006).
65. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006).
66. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006), par. 65-66.
67. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006), par. 66.

Disney demonstrates, however, that claimants are not required to prove directors' actual intent to do harm to the company in order to assert directors' liability.

Disney's 'not in good faith' standard was later applied in the context of oversight liability. In *Stone*, the claimants alleged that the defendant directors of a bank are personally liable because they did not excise their oversight responsibilities in good faith. The claimants asserted that the directors failed to prevent bank employees from violating criminal laws or from causing the company to incur significant financial liability or both.[68] The Delaware Supreme Court followed the *Disney* reasoning for determining directors' lack of good faith by requiring 'intentional failure to act in the face of a known duty to act, demonstrating a conscious disregard for ones duties.'[69] Importantly and consistent with *Disney*, the Court affirmed in *Stone* that the conditions for oversight liability accorded with those articulated in *Caremark*:

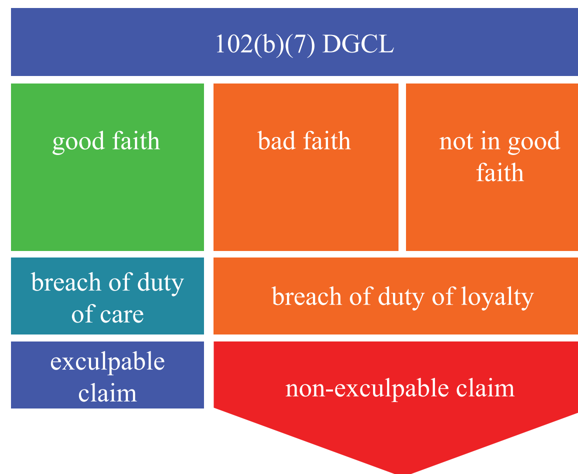
> '(a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.'[70]

The Court then held that, in the absence of red flags, "only a sustained or a systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability."[71] The allegations were ultimately found insufficient, resulting in dismissal for failure to establish a demand futility. The particular facts raised in the complaint could not create reasons to doubt whether the directors had acted in 'good faith' in exercising their oversight responsibilities.

Accordingly, Figure 3 visualises the treatment of non-exculpated claims under *Disney* and *Stone*.

68. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006), par. 373. Investigations were conducted by the USAO, the Federal Reserve, FinCen and the Alabama Banking Department. No fines or penalties were imposed on AmSouth's directors (par. 365).
69. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006), par. 369.
70. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006), par. 370.
71. *Stone v. Ritter*, 911 A. 2d 362 (Del. 2006), par. 372-373.

Figure 3. Non-exculpated claims under *Disney* and *Stone*



The 'not in good faith' standard was also applied in a change of control context, where Lyondell's board approved the transfer of control to Basell. The deal was characterised as an 'absolute home run' by Lyondell's financial advisor, Deutsche Bank. Less than thirteen months after the closing of the merger in December 2007, Lyondell filed for bankruptcy. The board's decision was reviewed under the *Revlon* standard.[72] In *Lyondell*, the Chancery Court denied the directors' summary judgment because the directors' 'unexplained inaction' prevented the court from determining that they had acted in good faith.[73] The Supreme Court reached a different outcome. First, the Delaware Supreme Court considered that bad faith could only be found if 'a fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.' Moreover, 'in the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.'[74] Paramount in *Lyondell* is the Court's emphasis that directors' decisions must be reasonable, not perfect.[75] 'Instead of questioning whether disinterested, independent directors did

72. Under Revlon's heightened standard of review, directors are required to get 'the best price for the stockholders at a sale of the company' (*Revlon, Inc. v. MacAndrews & Forbes Holdings*, Inc., 506 A.2d 173 (Del. 1986), par. 182. Revlon requires a reasonableness test. Directors may discharge this obligation, while having a choice of means, under the condition that they undertake reasonable steps to get the best deal for the stockholders. See for more elaboration on the Revlon duties under an enhanced scrutiny test: Assink 2007 p. 354-362.
73. *Ryan v. Lyondell Chemical Co.* 2008 WL 4174038 (Del. Ch. 2008) (*Lyondell II*), par. 5.
74. *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), par. 243 (citing *In re Lear Corp. Shareholder Litigation*, 697 A.2d 640 (Del. Ch. Sept. 2, 2008), par. 654).
75. *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), par. 243.

everything that they (arguably) could have done to obtain the best sale price, the [trial court's, TP] inquiry should have determined whether those directors utterly failed to attempt to obtain the best sale price.'[76] Accordingly, only if directors knowingly failed to undertake – consciously disregarded – their responsibilities, hence acted not in good faith, would they breach their duty of loyalty and be liable.

In the recent *Chen*[77] case, the director argued, while relying on *Lyondell*, that the claimants' allegations were insufficient to support a non-exculpated duty of loyalty claim because they did not establish that the directors 'consciously disregarded known obligations imposed by *Revlon*.' The Chancery Court rejected this position and clarified that conscious disregard is not the only way to establish a non-exculpated claim against directors in a change of control transaction.[78] Proper motive did however play a central role. In the specific *Chen* case, the court held that the claimants 'did not contend that the directors consciously disregarded known duties.' Instead, '[claimants] properly relied on another line of Delaware precedent,' which provides that a fiduciary's lack of good faith can be established by showing that he or she 'intentionally' acted with a purpose 'other than advancing the best interests of the corporation.'[79] Applying this standard, the *Chen* decision suggests that Occam's directors could be found to be personally liable of monetary damages in circumstances where their conduct fell outside the range of reasonableness if there is sufficient evidence

76. *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), par. 244.
77. *Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014). The court's decision was made in the context of summary judgment motions by the defendant directors and officers. Two issues were considered: the sale process claim and the disclosure claim. I will limit myself to only discussing the sale process claim. Nonetheless, it is important to stress that *Chen* is best understood when read in conjunction with the court's consideration of the facts involving the disclosure claims, which raised sufficient inferences that the Proxy Statement contained material misleading disclosures and material omission and that Occam's directors sought to conceal evidence thereof.
78. Holding that 'the Lyondell court stressed the fact that "[the] Disney decision expressly disavowed any attempt to provide a comprehensive or exclusive definition of bad faith." This aspect of the Lyondell decision precludes any suggestion that the Delaware Supreme Court thought that the conscious disregard of known duties was the only type of bad faith' (*Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014), par. 683).
79. *Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014), par. 684, citing *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), par. 369. And citing *In re El Paso Corporation Shareholder Litigation*, 41 A.3d (Del. Ch. 2012), par. 439 ("[A] range of human motivations … can inspire fiduciaries and their advisors to be less than faithful to their contextual duty to pursue the best value for the company's stockholders.")

of some improper motive, even if that improper motive did not lead Occam's directors to knowingly disregarding their responsibilities.[80]

Accordingly and as demonstrated in the cases above, exculpation will be denied when reviewing the applicability of exculpatory clauses only if the claimant sufficiently pleads facts supporting a rational inference that the director concerned acted in 'bad faith', that is in 'subjective bad faith' or 'not in good faith', where 'subjective bad faith' actions may concern actions motivated by an actual intent to do harm and a knowing violation of law,[81] and actions 'not in good faith' may concern a knowing disregard of duty or failure to act in the face of a known duty[82] and actions with improper motive which were not in the interest of the company.[83] As the cases discussed in this paragraph show, a director acting under these conditions would violate his or her fiduciary duty of loyalty and will not be able to rely on the protection of section 102(b)(7) DGCL. Moreover, it can be deduced from these cases that directors' good faith requirement in 102(b)(7) DGCL involves 'subjective good faith'.

4.3 How Dutch law differs from Delaware law

4.3.1 Discharge from directors' liability: the framework

Discharge from directors' liability exists as a long standing Dutch business practice. Where, in the context of internal directors' liability, a Dutch company suffers damages as a result of the actions of a director, the company may claim damages from the director concerned based on article 2:9 DCC. Dutch company law allows the company to renounce any actual or potential claims against the director − management and supervisory directors, executive and non-executive directors − by granting a discharge from directors' liability. Traditionally, two forms of discharge proposals are distinguished. The first is the annual discharge, granted by means of a resolution of the general meeting of shareholders (art. 2:101[3]/210[3] DCC) and based on the company's

80. *Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014), par. 685. The Chancery Court eventually considered that all Occam directors other than Occam's CEO, Howard-Anderson were disinterested and independent. Moreover, the court found that there was insufficient evidence to infer that the disinterested and independent directors acted with an improper motive and granted the director defendants' motion for summary judgment. As for Howard Anderson, the court found that he was interested in the merger because he personally received financial benefits from the merger that were not shared with the shareholders. Therefore, the exculpatory provision could not protect him.
81. *In re Walt Disney Company Derivative Litigation*, 906 A. 2d 27 (Del. 2006), par. 65-66.
82. As was discussed in the *Stone*, *Caremark* and *Lyondell* cases.
83. As was discussed in the *Chen* case.

annual financial statements.[84] The second is the final discharge, provided in the event that a director leaves the service of the company and desires that the liability protection covers the full term of directorship. Final discharge may be granted by means of a shareholders' resolution or by means of a settlement agreement [vaststellingsovereenkomst].[85] To date, existing case law permits a company to discharge directors of 'subjective bad faith' actions. A discharge provision insulates serious reproachable conduct, including 'subjective bad faith' conduct, which otherwise would result in the liability of the director to the company, providing the potential litigious conduct was 'known' to the company's shareholders.[86]

Despite its reputation as a waiver of right, the protection provided is often treated in court proceedings as an affirmative defence [bevrijdend verweer].[87] This means that when confronted with court proceedings, the defendant director must invoke the discharge in his defence and bear the burden of demonstrating good faith reliance on a validly provided discharge provision to rebut the claim of directors' liability.[88] Generally, the liability question is first raised and reviewed before the court proceeds to assess whether the defendant is discharged of paying damages that was attributable to serious reproachable conduct.[89]

In the absence of statutory rules on how to review a director's recourse to such a waiver, the Dutch Supreme Court has established in *Staleman v. Van de Ven* a doctrine on 'limited scope' which the Court reasoned to be adequately corresponding to the implication of such a waiver of rights.[90] To protect the company against potential disproportionate, harmful effects of the discharge, I understand the established method of judicial review as concentrating on the

84. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1. (*Staleman v. Van de Ven*); Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 4.2 (*De Rouw v. Dingemans*).
85. Court of Appeal 's-Gravenhage, 14 June 2011, ECL:NL:GHSGR:2011:BQ9535, par. 21 (*Dacotherm v. Topvorm*).
86. Dutch Supreme Court, 20 October 1989, NJ 1990, 308 (*Ellem v. De Bruin*).
87. District Court Dordrecht, 25 August 2010, ECLI:NL:RBDOR:2010:BN5148, par. 5.6.
88. Pursuant to art. 150 of the Dutch Code of Civil Procedure.
89. I coded eleven cases involving the courts' consideration of discharge between 1 January 2003 and 1 September 2013. In all of these cases, discharge was considered in the event of the director's defence, preceded with the court's assessment of the director's liability (see Table 9).
90. Dutch Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1 (*Staleman v. Van de Ven*). See also the conclusion by A-G Timmerman, 25 June 2010, ECLI:NL:PHR:2010:BM2332, par. 3.2 and 3.9 (*De Rouw v. Dingemans*) referring to Supreme Court 17 June 1921, *NJ* 1921, 737 (*Deen v. Perlak*) and Supreme Court, 20 June 1924, *NJ* 1924, 1107 (*Truffino*). Without detailed reasons being given on why 'limited scope' should be applied in the context of discharge, it is assumed in literature that such discharge should be classified as a relinquishment of the right of action (art. 6:160 DCC). And for such

knowledge of those authorised to grant the director the discharge, generally the company's general shareholders' meeting.[91] It is important to note that the general shareholders' meeting does not have an obligation to inform themselves [onderzoeksplicht].[92] In proceedings, courts infer the presence of this knowledge from the company's books and financial statements or other communications made to the shareholders' meeting. Accordingly, I understand the Dutch Supreme Court's legal reasoning as characterised with the following pattern:

1. A discharge from directors' liability is classified as a legal act of relinquishing an essential legal remedy of the company against its directors' in the context of internal directors' liability. Such waiver of rights should be made consciously and knowingly within the context of a general shareholders' meeting in order to have legal effect.[93]
2. The requirement of knowledge is satisfied if the legal act was based on 'known' actions that can be traced from the financial statements as presented to the general shareholders' meeting, or actions that otherwise were known to the general shareholders' meeting prior to its decision to grant discharge.[94]
3. Once discharge was consciously provided to a director, the director concerned is exempted of liability for serious reproachable conduct, including 'subjective bad faith' conduct.[95]
4. Accordingly, and as a principle, the director may rely in good faith on a validly provided discharge provision as a defence against directors' liability for serious reproachable conduct, including 'subjective bad faith' actions.[96]

Note that, in this research, I will treat 'subjective bad faith' as distinct from 'not in good faith'. The latter type of conduct does not involve the intent to cause harm to the company. Both are however regarded 'bad faith' actions constituting a serious reproach. The importance of this distinction will become clear in the subsequent paragraphs 4.3.2.

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waiver of rights to have legal effect, those who performed the legal act are required to have been conscious and knowledgeable of the legal effect of such act (see Assink & Slagter 2013, p. 1152). Accordingly, the purpose of such requirement is to protect those who were insufficiently aware of the effect of such waiver of rights (Van Wijk 2011, p. 127).

91. As I have noted in paragraph 4.1.3, it is a common practice in European countries to base discharge proposals on the companies' financial statements or other documents informing the general shareholders' meeting about potential litigious actions. The scope of the discharge varies across the jurisdictions however. Under specific conditions, the Netherlands, Sweden and Switzerland allow a discharge to cover bad faith conduct.
92. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1 (*Staleman v. Van de Ven)*.
93. *Staleman v. Van de Ven*; *Deen v. Perlak* and *Truffino*.
94. *Staleman v. Van de Ven.*
95. *Ellem Beheer v. De Bruin* and *De Rouw v. Dingemans*.
96. *Ellem Beheer v. De Bruin*.

I will now consider how (lower) courts have reviewed discharge claims (2003-2013).

4.3.2 *Empirical insights: the courts' review of discharge claims*

This empirical part of the research is based on 11 coded cases in which a defendant director raised the protection of a discharge provision and subjected it to judicial review.[97] It is the aim of this research to deepen the understanding of the relation between directors' discharge claims and the courts' decision: whether the director was held liable or not. I will observe if and how a discharge provision could effectively shield directors from personal liability to the company. Moreover, I wish to identify cases in which directors' 'bad faith' was at issue and to understand how courts have coped with these 'bad faith' cases.

In accordance with the pattern of legal reasoning in paragraph 4.3.1, I will focus on the following four variables. The first variable, 'discharge provided', involves whether in a given case the court judged that the discharge was granted or that, in fact, the case concerned a non-existent legal act. The second variable, 'in scope', involves whether the court determined that the discharge was based on 'known' actions that can be derived from the financial statements or were otherwise presented and known to the general shareholders' meeting. The third variable, 'subjective bad faith', involves whether the court found that the director had acted with the intent to do harm. The fourth and final variable, 'director liable', involves whether, in a given case, the court deemed the director to be personally liable to the company, despite the director's discharge claim.

Table 9. Discharge claims and courts' review

Case	Discharge Provided	In scope	Subjective bad faith	Director liable
Final discharge				
Traffic Service Nederland B.V.	X	-	X	X
Dacotherm v. Topvorm	X	X	-	-
Ceteco*	-	-	-	X
Periodical discharge				
De Rouw v. Dingemans	X	-	X	X
!Go B.V. v. X	X	X	-	-
Vereniging Schuttersgilde	-	-	X	X
Wijsmuller v. Louder Holdings	X	-	X	X
Ceteco*	-	-	-	X

97. See paragraph 4.1.3 and paragraph 3.3.2 for more details.

Case	Discharge Provided	In scope	Subjective bad faith	Director liable
Altera Pars Media B.V.	-	-	-	X
Matkovic v. Exhol	X	-	-	-
Berghuizer Papierfabriek	-	-	X	X
Total				
Yes	6	2	5	8
No	5	9	6	3
N = 11				

* This case was coded twice because the court assessed two forms of discharge, annual and final discharge.

4.3.2.1 Did the general shareholders' meeting grant discharge?

Of the 11 cases which have been coded, the court determined that the director was granted discharge from directors' liability in 6 cases. In 5 cases, no discharge was granted to the defendant director (see Table 9 under 'discharge provided').

In the 5 cases in which the court denied that the director was granted discharge, the director was held liable. For instance, in *Vereniging Schuttersgilde*, the district court reasoned that a discharge decision could not have been taken by the general meeting, which had been kept ignorant about the litigious actions.[98]

In *Ceteco*, the district court ruled that not all shareholders were conscious of the litigious actions for which the defendant director claimed to have been discharged. The fact that Ceteco's parent company, Hagemeyer, held 65% of the shares and was fully informed about Ceteco's business decisions and associated risks, did not alter the court's conclusion: the remaining 35% of the shares was with Ceteco's Trust Office Foundation (STAK). Moreover, neither parties argued nor made plausible that the board of Ceteco's Trust Office Foundation was informed of Ceteco's business decisions and associated risks for which the director would be discharged.[99] Furthermore, in reviewing a settlement agreement between the director and the supervisory board, the court held that, despite the written recommendation to the general shareholders' meeting to discharge the director, such stipulation cannot lead to the conclusion that discharge was effectively provided by the general shareholders' meeting.[100]

98. District Court Arnhem, 23 April 2008, ECLI:NL:RBARN:2008:BD1784, par. 4.12 (*Vereniging Schuttersgilde*).
99. District Court Utrecht, 12 December 2007, ECLI:NL:RBUTR:2007:BB9709, par. 5.122 (*Ceteco*).
100. District Court Utrecht, 12 December 2007, ECLI:NL:RBUTR:2007:BB9709, par. 5.127 (*Ceteco*).

In *Altera Pars Media B.V.*, the district court rejected the director's submission of an email message as proof that discharge was provided. Despite the statements made in the email message and in absence of confirmation in writing, the court reasoned that it cannot be concluded that the general shareholders' meeting had effectively discharged the director for the litigious actions.[101]

4.3.2.2 Did the litigious actions fall under the scope of the discharge?

Of the 6 cases in which the court decided that discharge was granted to the defendant director, there are 3 cases in which the litigious actions involved 'bad faith'. In these 3 'bad faith' cases, the court did not allow the litigious actions to fall under the scope of discharge.[102]

Of the 6 cases in which the court acknowledged that discharge was granted, the court only allowed the litigious actions to be protected by the discharge provision in 2 instances (see Table 9 under 'in scope'). In both cases, the court explicitly ruled that the litigious actions did not involve 'bad faith' or serious reproachable actions. In *Dacotherm v. Topvorm*, the director was granted discharge by means of a settlement agreement as part of his resignation.[103] Dacotherm's directors were, along with De Kerf, Dacotherm's indirect shareholders. The District Court considered that the litigious actions were 'known' actions to Dacotherm's general shareholders' meeting based on the content of the board's reports that were, as was confirmed in proceedings, at the disposal of De Kerf and her advisors. The court assumed that De Kerf must have been aware of the company's difficulties due to a highly increased order portfolio and lagging production capacity.[104] In *!Go B.V. v. X*, the director was alleged to have acted fraudulently by making unauthorised payments to himself. Upon the defendant's counterclaim, the District Court determined that the director was wrongly accused of fraud.[105] The court ruled that the payments were disclosed in the annual financial statements and that the defendant director was

101. District Court Amsterdam, 21 November 2007, ECLI:NL:RBAMS:2007:BC1308, par. 4.1 (*Altera Pars Media B.V.*).
102. These cases are: Court of Appeal Arnhem-Leeuwarden, 23 April 2013, ECLI:NL:GHARL:2013:CA1206 (*Traffic Service Nederland B.V.*); Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*); Court of Appeal Amsterdam, 9 December 2008, ECLI:NL:GHAMS:2008:BJ4454 (*Wijsmuller v. Louder Holdings*).
103. Court of Appeal 's-Gravenhage, 14 June 2011, ECLI:NL:GHSGR:2011:BQ9535, par. 21 (*Dacotherm v. Topvorm*).
104. Court of Appeal 's-Gravenhage, 14 June 2011, ECLI:NL:GHSGR:2011:BQ9535, par. 19 (*Dacotherm v. Topvorm*).
105. District Court Breda, 8 July 2009, ECLI:NL:RBBRE:2009:BJ2497, par. 3.27 (*!Go B.V. v. X*).

entitled to rely in good faith on the discharge granted to him for actions derivable from the financial statements, which were adopted by the general shareholders' meeting.[106]

4.3.2.3 Were the litigious actions qualified as 'subjective bad faith' actions?

It is first important to emphasise that the studied cases in which the litigious actions were covered by the protection of the discharge clause did not involve 'subjective bad faith' actions.

Of the 11 cases that have been coded, 5 cases did involve 'subjective bad faith' actions on the part of the defendant director. In all of the 5 cases, the director was found to be personally liable to the company; discharge could not absolve the defendant director of liability for 'subjective bad faith' actions. In 2 of these 'subjective bad faith' cases, the director committed a criminal offense. These involved *De Rouw v. Dingemans*[107] which I will discuss in more detail below and *Berghuizer Papierfabriek*.[108] I will first start with discussing the role played by the discharge provision in one exemplary case involving actions in 'subjective bad faith' but not a criminal offence, before moving to *De Rouw v. Dingemans*.

In *Traffic Service Nederland B.V.*, the director was judged personally liable for excessive, unauthorised, expense claims for the account of the company. The discharge could not be used as protection for the litigious actions. The District Court reasoned that information about the expense claims could not be derived from the financial statements. The fact that the external accountant had commented on the expenses incurred by management and a lack of any monitoring of them in the financial reports could not lead to the conclusion that the general shareholders' meeting was knowledgeable of these impermissible expenses.[109] Moreover, it was emphasised in this case that the director was held liable for serious reproachable, 'deliberate harmful acts.'[110]

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106. District court Breda, 8 July 2009, ECLI:NL:RBBRE:2009:BJ2497, par. 3.6 (*!Go B.V. v. X*).
107. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
108. Court of Appeal 's-Hertogenbosch, 15 June 2004, ECLI:NL:GHSHE:2004:AQ5636 (*Berghuizer Papierfabriek*).
109. Court of Appeal Arnhem-Leeuwarden, 23 April 2013, ECLI:NL:GHARL:2013:CA1206, par. 4.35 (*Traffic Service Nederland B.V.*) (in accordance with *Staleman v. Van de Ven* in which the Supreme Court held that the shareholders' general meeting did not have the obligation to inform themselves of the litigious action).
110. Court of Appeal Arnhem-Leeuwarden, 23 April 2013, ECLI:NL:GHARL:2013:CA1206, par. 4.37 (*Traffic Service Nederland B.V.*).

In *De Rouw v. Dingemans*,[111] the director committed fraudulent acts and manipulated the company's books and records to conceal the illegal acts. The director was convicted for the criminal offences. In the civil procedure, by analogy with *Staleman v. Van de Ven*,[112] the Supreme Court reasoned that knowledge of the fraudulent actions could not be derived from the financial statements.[113] Hence, De Rouw's general shareholders' meeting was not fully knowledgeable of the litigious actions for which they granted the discharge. There is something peculiar about this case however: de Rouw sr., the company's sole (indirect) director and shareholder committed the illegal acts and discharged himself of them. He was consequently fully knowledgeable of the fraudulent acts at all times. Evidently, the full knowledge of the litigious actions of de Rouw sr. was not considered decisive. In its decision, the Supreme Court found that a discharge may not extend to fraudulent acts which, due to manipulation of the books, were not discernible in the financial statements. Commentators have expressed their criticism and argued that mala fide directors still could get around the court ruling as long as they ensure that the bad faith actions are mentioned in the financial statements or other documents for the purposes of informing the shareholders' general meeting. When the shareholders' general meeting subsequently resolves to grant a director discharge, the bad faith actions are ostensibly known to them and mala fide directors could still rely on a validly provided discharge.[114]

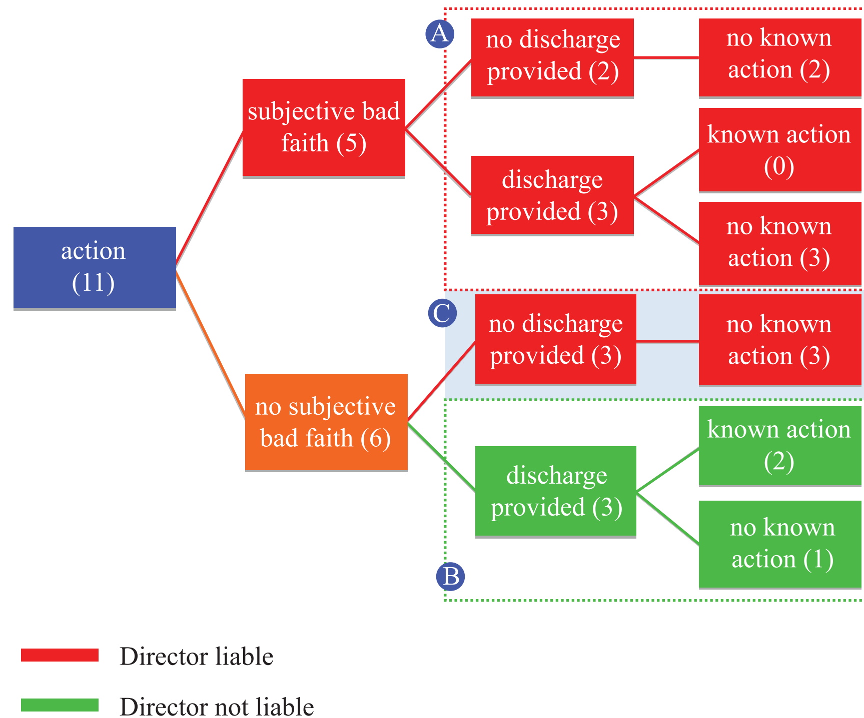
As I will demonstrate in paragraph 4.4.3, there is an alternative way to understand the judgment in *De Rouw* as not predominantly based on the logic of 'known' action but based on the voidness of the discharge by reason of immoral purpose (art. 3:40[1] DCC). Such discharge would not serve any reasonable company interest and should remain invalid.

4.3.2.4a 'No subjective bad faith' ≠ liable

Based on the observations in Table 9, it is clear that the requirement of 'known' action in the courts' assessments of discharge claims played no role in the determination of directors' liability. The courts were unwilling to allow a director to invoke a discharge as protection against liability in the event of actions in 'subjective bad faith', as shown by the illustration in Figure 4 under A.

111. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
112. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1. (*Staleman v. Van de Ven*).
113. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 4.2 (*De Rouw v. Dingemans*).
114. Van Wijk 2011, p. 127. See also the case note by J.B. Wezeman *JOR* 2010/227.

Figure 4. Legal practice: discharge and directors' liability



In Figure 4, I distinguished the cases involving actions manifesting 'subjective bad faith' and actions 'not in subjective bad faith'. It is apparent from the illustration that, in 3 cases, courts were only willing to acknowledge a director's discharge claim if 'subjective bad faith' was not evident (see Figure 4 under B). More precisely, the courts affirmed in these 3 cases that the director was not subject to serious reproach. In other words, discharge had no added value regardless of its legal validity or invalidity. The liability claim against the director would have been dismissed anyway. In *Dacotherm v. Topvorm* and *!Go B.V. v. X*, the directors could rely on the protection of the liability clause and it was affirmed that no bad faith or serious reproachable conduct on the part of the director concerned was involved.[115] In *Matkovic v. Exhol* on the other hand, the court held that a discharge had been granted to the director but did not extend to cover the litigious action. Nevertheless, the liability claim against the director was

115. Court of Appeal 's-Gravenhage, 14 June 2011, ECLI:NL:GHSGR:2011:BQ9535 (*Dacotherm v. Topvorm*) and District Court Breda, 8 July 2009, ECLINL:RBBRE:2009:BJ2497 (*!Go B.V. v. X*).

dismissed because the action could not be qualified as serious reproachable conduct for which the director could be held personally liable to Exhol.[116]

4.3.2.4b 'No subjective bad faith' = liable, hence 'not in good faith'

I now wish to examine those cases in which 'no subjective bad faith' was involved, a discharge provision could not provide protection and the director nevertheless was held personally liable to the company (see Figure 4 under C). The cases involve *Ceteco*[117] and *Altera Pars Media B.V.*[118] Note that *Ceteco* has been double-coded.[119] In both cases the claims were instigated by the trustee in bankruptcy.

In *Ceteco*, the district court ruled that the executive directors and supervisory directors were personally liable to the company for a series of activities, including irresponsible investment and acquisition policy, failing risk management and internal mismanagement, and violation of internal norms and policies intended to safeguard the company against excessive risks.[120] The essential legal argument was based on the circumstance that Ceteco's directors, while conscious of the risks due to over-expansion and knowingly violating internal norms, continued to give priority to the company's growth strategy to the detriment of the company's financial capacity and internal organisation. Under these circumstances it can be said that the directors did not act in good faith in serving the interests of the company.

Altera Pars Media B.V. involved an effort by Imca to take over all the shares of Altera's ailing company. For this purpose, one of Imca's employees was appointed sole director on Altera's board. Imca ultimately refrained from acquiring Altera and the director resigned. Altera's subsidiary companies, printing company B and SSN, were declared bankrupt soon thereafter. The District Court ruled, that the director was personally liable regardless of his service of barely one and an half months.[121] In the light of the director's appointment on the board of Altera in connection with the potential acquisition by Imca, the

116. Court of Appeal 's-Hertogenbosch, 28 September 2004, ECLI:NL:GHSHE:2004:AS5955, par. 4.3.2-4.3.5, 4.4.5 (*Matkovic v. Exhol*). The litigious action involved a failure by the director to inform Exhol's general shareholders' meeting about an additional tax assessment imposed on Exhol in connection with the rent for a staff residence which the director occupied. The paltry sum of money and negligence on the part of the director could not give rise to sufficient serious reproach to assume the liability of the director.
117. District Court Utrecht, 12 December 2007, ECLI:NL:RBUTR:2007:BB9709 (*Ceteco*).
118. District Court Amsterdam, 21 November 2007, ECLI:NL:RBAMS:2007:BC1308 (*Altera Pars Media B.V.*).
119. See also the asterisk in Table 9.
120. District Court Utrecht, 12 December 2007, ECLI:NL:RBUTR:2007:BB9709, par. 5.166-5.168, 5.171 (*Ceteco*).
121. Based on art. 2:9 DCC in conjunction with art. 2:11 DCC.

court assumed that the director was knowledgeable of Altera's financial affairs. The legal argument was based on the circumstance that the director continued Altera's centralised financial housekeeping practice to the detriment of its subsidiaries (and creditors of) B and SSN. The court ruled that the director knew or should have known that, by approving the transfers from B and SSN to subsidiary C and subsequently paying only the creditors of subsidiary D, which had no credible prospect of survival (D eventually entered bankruptcy), any possibility of recovery for the creditors of B and SSN was made illusory. Hence, the director did not act in good faith and in the interests of companies B and SSN, on account of which he was subject to serious reproach.[122]

In these two cases in which 'subjective bad faith' was not at issue, the directors nonetheless acted at the very least 'not in good faith' and not in the interests of the companies that they served. While *Ceteco* provides a basis for arguing that the directors were deliberately reckless, it can be argued in *Altera Pars Media* that the director utterly failed to act in the interests of the company that he served. The cases illustrate that in spite of the absence of malicious intent by a director to cause the company harm, a director nonetheless runs the risk of personal liability if he or she should have known to have acted to the detriment of the company or failed to act in the interest of the company.

The outcome of the two cases described above are interesting for two reasons. First, these two cases demonstrate that courts are inclined to prevent the assumed discharge from having legal effect to actions 'not in good faith' and not in the interest of the company. Second, in these two particular cases the court did not review the assumed discharge materially. Instead, the court found an elegant escape by judging that the assumed discharge was not in fact granted to the directors concerned by the general shareholders' meeting (see paragraph 4.3.2.1) and judged the directors personally liable. It remains therefore uncertain how courts will review discharge claims materially in the face of 'not in good faith' actions as were identified in *Ceteco* and *Altera Pars Media*. To put it differently, do courts – in reality – require directors' *subjective* good faith as a condition for discharge, or *objective* good faith? Based on *Ellem v. De Bruin* and *De Rouw v. Dingemans*[123] which I will discuss in paragraphs 4.4.2-4.4.3, it seems not unlikely that a court in practice will honour a discharge to apply under the condition of subjective good faith even though a director's action qualified a serious reproach. It seems however far away from legal doctrine that a court requires objective good faith as a condition for discharge. If the latter would be

122. District Court Amsterdam, 21 November 2007, ECLI:NL:RBAMS:2007:BC1308, par. 4.4 (*Altera Pars Media B.V.*).
123. Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308, par. 3.1 (*Ellem v. De Bruin*) with case note J.M.M. Maeijer; Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).

true, discharge would arguably be a corporate governance instrument without legal effect.

4.3.3 Summary

In analysing Delaware's case law based on section 102(b)(7) DGCL, I discussed how good faith constitutes a condition of the duty of loyalty (paragraph 4.2.1). Moreover, I emphasised in paragraph 4.2.5 that the good faith requirement in section 102(b)(7) DGCL, allowing a director the protections of the exculpatory provision against duty of loyalty claims, involves a director's subjective good faith. As the Delaware Supreme Court noted in *Stone v. Ritter* when citing *Guttman*: 'a director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.'[124]

Compared to the logic of directors' subjective good faith applied in Delaware in accordance with section 102(b)(7) DGCL, the logic applied in the Netherlands in relation to the discharge from directors' subjective bad faith would seem to be completely opposite. The empirical findings in this research shows however differently. I could not find one single case in which a director was knowingly discharged of 'subjective bad faith' or 'not in good faith' actions (paragraph 4.3.2.4). The empirical findings would seem to suggest that, when deciding on a director's discharge claim, Dutch courts implicitly require directors to act at the very least in good faith. This finding stands in stark contrast with the existing legal doctrine on the 'limited scope of discharge' [de beperkte reikwijdte van de décharge], suggesting that a director may be discharged of personal liability for 'subjective bad faith' actions as long as these litigious actions were 'known actions' to a company's general shareholders' meeting.[125] The empirical findings reveal the problematic nature of the fact that existing doctrine does not explicitly require directors to act in good faith as a precondition for discharge from personal liability to the company. In conjunction with the findings from the legal comparison, it seems that the existing Dutch legal doctrine on the 'limited scope of discharge' is at odds with good corporate governance, which encourages directors to act in good faith and in the interest of the company. This contradiction need not exist.

Looking critically at the data in this research, it is important to distinguish between directors' *subjective* good faith and *objective* good faith. Objective good faith actions do not amount to a serious reproach: a discharge if invoked in a

124. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), par. 370.
125. Dutch Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman v. Van de Ven*); Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*); Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).

given case, would not influence court judgment. Serious reproach may however arise even if a director acted in subjective good faith. Discharge then may play a critical role to free a director of liability towards the company. In *Ceteco* and *Altera Pars Media*, the assumed discharge provision was judged non-existent and therefore could not free directors of liability for serious reproachable actions towards the company; directors' subjective good faith was not an issue. I argued in paragraph 4.3.2.4b nonetheless that on the basis of *Ceteco* and *Altera Pars Media*, it cannot be excluded that courts may discharge the director concerned of serious reproachable actions performed in subjective good faith. Basing on *Ellem v. De Bruin* and *De Rouw v. Dingemans,*[126] it is my assumption that discharge of directors' 'subjective bad faith' actions is more controversial and problematic then actions performed not in subjective good faith. In the next paragraphs I will explore the potential of 'subjective good faith' as a baseline for the review of discharge claims.

4.4 Rethinking discharge from directors' liability

Unlike in Delaware, where the scope of the exculpatory provision is restricted by law and has frequently been tested in court, Dutch courts must consider discharge claims case by case. As only few discharge claims have been brought under court review, Dutch case law on the topic of discharge is still evolving.[127] The comparative and empirical insights acquired in the previous paragraphs may contribute to further develop the Dutch concept of discharge. In this paragraph, I will focus on further developing the legal doctrine 'limited scope of discharge' by adopting directors' 'subjective good faith' as a baseline for the review of discharge claims. As the cases under study demonstrate, Dutch courts tend not to allow a discharge to apply to actions by directors performed in 'subjective bad faith'. At present, Dutch courts do, however, imply that the 'subjective good faith' of directors is a condition of discharge. In my opinion, making the 'subjective good faith' of directors an explicit condition would make the legal doctrine on discharge more consistent with empirical reality and would make it function more appropriately as a contributor to good corporate governance in the Netherlands.

126. Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*); Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
127. As I have shown in the empirical part of this research, I was able to code only 11 cases in which discharge claims were reviewed in relation to a directors' personal liability to the company (see paragraph 4.3.2 Table 9).

4.4.1 *Interpreting directors' 'subjective good faith' in Ellem Beheer v. De Bruin and De Rouw v. Dingemans*

Although not directly addressed in Dutch case law to date, the best explanation for why courts deny discharge of directors when 'subjective bad faith' actions are involved may lie in the legal constraints imposed by good morals and public order (art. 3:40 DCC) and the standard of reasonableness and fairness (art. 2:8 DCC). Within this 'method', courts may take their own initiative either ex officio or on the request of the litigant in ruling the discharge resolution void (art. 3:40[1] DCC) or inapplicable (art. 2:8[2] DCC).[128]

The method might or could have been applied in two landmark cases, *Ellem Beheer v. De Bruin*[129] and *De Rouw v. Dingemans.*[130] In my view, the following two legal questions might or should have been addressed in both cases in cassation before the Supreme Court[131]:

– Notwithstanding the knowledge of the general shareholders' meeting of the litigious action, is the discharge decision legally valid on the basis of good morals and public order (art. 3:40 DCC)?
– If valid, is the applicability of the discharge decision nonetheless unacceptable in light of the circumstances under the standards of reasonableness and fairness (art. 2:8 DCC)?[132]

The first question involves the legal validity of the discharge decision. If the discharge is legally valid, the second question subsequently turns to the issue of applicability of the discharge decision, given the circumstances and the demands of reasonableness and fairness. In the next paragraphs, I will show how art. 3:40(2) and 2:8(2) DCC may function as important corrections

128. There may be other appropriate alternatives for challenging the effects of the discharge resolution, for instance on the basis of art. 2:15(1)(b) in conjunction with art. 2:8 DCC or art. 2:356(a) DCC. In this research, I focused however on the functionality of good morals and public order and the effect of reasonableness and fairness as stepping stones for introducing directors' subjective good faith into the understanding of the Dutch concept of discharge.
129. Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308 (*Ellem v. De Bruin*).
130. Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
131. As an aside, it must be recognised that in practice, in dealing with a matter of law, the Supreme Court is bound to the means of cassation.
132. See also Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308, par. 3.2 (*Ellem v. De Bruin*).

to the legal logic of 'known' action. The legal standards enable courts to do justice to all the relevant circumstances in a given case, including a director's 'subjective good faith', in order to protect the interests of the company by preventing a discharge from covering directors' 'subjective bad faith' actions. In so doing, I will apply the method described above to the arguments in *Ellem Beheer* and *De Rouw*. The result is a reinterpretation of these two cases, which I will refer to as *Ellem Beheer 2.0* and *De Rouw 2.0.*

4.4.2 Ellem Beheer v. De Bruin 2.0

Ellem involved a one-man private company (B.V.). All except one of its shares were held by Mr de Bruin, who was the company's sole director. The remaining share was held by Mrs de Bruin. The couple decided to sell their shares in the company. After the sale but before the transfer of the shares, Mr. de Bruin, on behalf of the company, provided a loan in the amount of 1.9 M guilders to Bungalet, a Swiss AG, without investigating the solvability of the AG or requiring security or any other conditions for repayment. In Ellem's financial statements of June 1983, the transfer order was specified as a loan to Bungalet AG. On 25 May 1983, the entire share capital was sold and transferred by deed in exchange for an amount of 2 M guilders to H. Ritter-Wagner who was represented by Hazewinkel. Moreover, parties to the sale have declared to be 'knowledgeable of the transactions in the company's equity from 1 January 1983 to date and require no further particulars.'[133] On the same date, at the occasion of the general meeting of shareholders, De Bruin was granted final discharge as part of his resignation procedure. After 25 May 1983, Ellem's shares were sold and transferred several times and changes took place in the company's board. In August 1985, on Ellem's inspection, it appeared that Bungalet AG was not registered in the Swiss commercial registers and that any recovery was likely illusory. Ellem instigated a claim for damages. De Bruin stated in his defence that Ellem's general shareholders' meeting had provided him final discharge.

The Supreme Court first judged that the discharge decision was legally valid and had passed the test of good morals and public order (art. 3:40 DCC). Two circumstances may or could have been important: i) the full knowledge that Ellem's shareholders possessed with regard to the litigious transaction when granting De Bruin discharge, and ii) the interests of Ellem's company and the disadvantage that the discharge could bring to the company.

133. Dutch Supreme Court, 20 October 1989, *NJ* 1990, 308, par. 3.1 (*Ellem v. De Bruin*) with case note J.M.M. Maeijer.

In the specific case, Ellem's shareholders were fully knowledgeable of the litigious transaction; the transaction was specified in Ellem's financial statements. Finally, parties to the sale declared themselves to be fully knowledgeable of all changes in Ellem's equity in the deed of sale, including the litigious transaction. The Supreme Court originally held that De Bruin's intent was an irrelevant factor.[134] Accordingly, the Supreme Court did, on no account, infer or deem that De Bruin had defrauded the company or acted intentionally harmful to the prejudice of the company.[135] Neither did the Supreme Court adopt factual assumptions indicating De Bruin's conduct in 'subjective bad faith'.[136] The Supreme Court held the discharge to be legally valid and effectively covering the litigious action, 'even if De Bruin would have acted intentionally or negligently to the detriment of the company.'[137] Here is why. In the particular case, the discharge was not in conflict with the company's interest. Ellem was a one-man B.V. that was directed and controlled by De Bruin, whose personal interest was identified with the company's interest, or at least, was inseparable.[138] Other than De Bruin, Ellem had no employees and did not conduct any business. Under these conditions, the company's interest was not violated. Indeed, Ellem suffered no effective harm.

Once the discharge was judged legally valid, the next legal question involved the applicability of the discharge resolution. Under art. 2:8(2) DCC, a valid discharge decision may only be set aside in exceptional circumstances in which the applicability of the discharge would lead to 'unacceptable' results under the standards of reasonableness and fairness.[139] Article 2:8(2) DCC thus imposes a restrictive judicial review in service of legal certainty. In this specific case,

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134. See also the case note J.M.M. Maeijer, par. 3.
135. See *GBL v. De Graaf* in which the district court did not infer or judge that De Graaf had defrauded the company. GBL's director and shareholder was alleged to have deprived the company of assets and funded other private companies instead. De Graaf was successful in invoking discharge in his defence. All payments made, were accounted for in GBL's bookkeeping. Moreover, all GBL's shareholders were knowledgeable of the litigious actions when granting De Graaf final discharge as part of De Graaf's resignation procedure and transfer of shares (District Court Overijssel, 18 June 2014, ECLI:NL:RRBOVE:2014:3475).
136. Unlike in *De Rouw*, where the Supreme Court took de Rouw's criminal offence and prison sentence as the starting point for review in cassation (Dutch Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 3.1).
137. Dutch Supreme Court, 20 October 1989, NJ 1990, 308, par. 3.3 (*Ellem v. De Bruin*).
138. See also the case note J.M.M. Maeijer, par. 4.
139. Accordingly, judicial review of a discharge resolution that might be 'unacceptable' is more restricted than a resolution that might be 'unreasonable'. See Slagter & Assink, *Compendium Ondernemingsrecht*, Deventer: Kluwer 2013, par. 11.2, based on Supreme Court, 25 February 2000, ECLI:NL:HR:2000:AA4942, par. 3.4 (*Vervoersbond FNV v. Frans Maas Nederland*). Therefore, under the more restricted review, only under exceptional circumstances would a director not be able to rely on a discharge granted to him (see also the conclusion, by A-G Timmerman, 25 June 2010, in *De Rouw v. Dingemans*, ECLI:NL:PHR:2010:BM2332, par. 4.10).

there were no such exceptional circumstances. Since Ellem's shareholders were all knowledgeable of the litigious action and since the discharge, intended to protect against the litigious action, could not be deemed void, De Bruin could effectively rely on the discharge that was granted to him in his defence.

Accordingly, Ellem Beheer *2.0* demonstrates that a company may, represented by its general shareholders' meeting, freely and legally waive the right to seek legal redress from its director even to its own disadvantage. In the case in question, De Bruin was not accused of defrauding the company or acting with the intent to harm the company; the general shareholders' meeting was fully knowledgeable of the litigious action, and the litigious action did not cause any effective harm to the company. Under the given circumstances, the discharge resolution did not therefore run contrary to the company's interest. Hence, the Supreme Court indeed did not impose legal constraints on the 'freedom of contract'. This will, however, appear otherwise when I reinterpret *De Rouw v. Dingemans*[140] in the next paragraph. The discharge will then not serve any reasonable company interest and be deemed null and void.

4.4.3 De Rouw v. Dingemans 2.0

De Rouw B.V. was a single-shareholder company with a metal business and a few employees in service. The company was directed and controlled by De Rouw sr., the company's (indirect) sole shareholder and director. De Rouw B.V. went bankrupt, and the trustee in bankruptcy claimed that De Rouw sr. violated his duty of proper management of the company by depriving the company of its assets. The trustee alleged that De Rouw sr. acted fraudulently and therefore could be susceptible to serious reproach. In the course of the proceedings, it was established that De Rouw sr. had committed tax fraud and forgery and was sentenced to imprisonment. Moreover, De Rouw sr. deliberately deployed the company's assets for private use and debited the company by arranging payments for phantom invoices. The fraudulent acts had remained concealed by manipulating the company's books and accounts, and the litigious actions were not discernible in the financial statements. In his defence, De Rouw sr. invoked the discharge provision and argued that it covered the litigious, illegal actions, as the company's general shareholders' meeting, consisting solely of De Rouw sr. himself, was fully informed. In cassation, the Supreme Court accepted De Rouw's full knowledge of the litigious actions,[141] yet judged as follows:

140. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332 (*De Rouw v. Dingemans*).
141. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 4.1 (*De Rouw v. Dingemans*).

> '(...) such a discharge does not extend to fraudulent acts which were facilitated by manipulation and were not made apparent in the company financial statements and annual report.
>
> The circumstance that De Rouw sr. as the company's (indirect) sole director and shareholder at each meeting approved the financial accounts and annual reports, must have carried knowledge of the litigious actions cannot lead [to a different judgment, TP].'[142]

The Supreme Court may or could have used the method in *Ellem Beheer 2.0* to resolve the circumstances argued in *De Rouw.*

The first issue is De Rouw's knowledge of the fraudulent actions regardless of their discernibility in the company's records. In the particular circumstances of this case, the books and accounts were manipulated. De Rouw's knowledge may be considered a relevant circumstance but did not evidently play a decisive factor in the court's final judgment. De Rouw's full knowledge did not convince the court to adopt a different view. On the basis of *a contrario* reasoning in relationship to *Ellem Beheer 2.0*, the judgment in *De Rouw* may be better explained by other additional circumstances, to wit: the nullity of the discharge resolution on the basis of good morals and public order (art. 3:40 DCC).

The second issue, accordingly, involves the immoral purpose of the discharge decision based on art. 3:40 DCC. In cassation, the Supreme Court could have explicitly taken De Rouw's criminal offences as the starting point of the judicial review by applying, ex officio, art. 3:40 DCC in conjunction with art. 25 of the Code of Civil Procedure (CCP) when considering the validity of the discharge. If, pursuant to art. 25 CCP, a discharge proves to be null and void, a court must act on its own motion to consider the invalidity of the discharge even if not contested by one of the litigants.[143] *Hoeben v. Noord Nederlandse Metaalhandel*[144] may offer important guidance in considering the problematic issue of discharge in *De Rouw 2.0* in view of art. 3:40 DCC. The casuistry in *Hoeben* is quite similar to that of *De Rouw.*

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142. Supreme Court, 25 June 2010, ECLI:NL:HR:2010:BM2332, par. 4.2 (*De Rouw v. Dingemans*).
143. In contrast, the court did not consider art. 3:40 DCC on its own motion in *Ellem Beheer*, but as response to Ellem's plea. To resist De Bruin's claim to discharge, Ellem pleaded (unsuccessfully) that the discharge was null and void.
144. Supreme Court, 8 July 1991, ECLI:NL:HR:1991:ZC0316, *NJ* 1991/765 (*Hoeben v. Noord Nederlandse Metaalhandel*).

Hoeben concerns three companies involved in the metal businesses, all of which were directed and controlled by Hoeben, the companies' sole shareholder and director. The companies' shares were then sold to Voth. After the sale, the Fiscal Intelligence and Investigation Service (FIOD) and the Government Audit Department (RAD) launched an investigation into the companies on alleged tax liability. In the course of the proceedings, it was established that Hoeben had deprived the companies of their assets for his own private benefit and illegally evaded tax payments.[145] The companies were then faced with additional tax assessments and instigated a claim for damages. In his defence, Hoeben asserted that he had acted on the basis of resolutions by the companies' general shareholders' meetings (i.e. Hoeben himself) 'allowing the director to evade tax payments and, contrary to legal obligation, to appropriate companies' earnings without accounting for it in the companies' bookkeeping.'[146] The Supreme Court confirmed the Court of Appeal's judgment that the shareholders' resolutions were null and void because they contained an immoral purpose, namely to allow illegal tax evasion.

In *De Rouw 2.0*, by analogy with *Hoeben*, it can be argued that the discharge decision may not have been directly prohibited by law; however, the legal act contained an immoral purpose: to shield a director from personal liability for fraudulent acts. Such discharge, with its intention of evading the legal consequences of fraudulent actions, does not serve any company interest.[147] Indeed, allowing such a discharge in *De Rouw 2.0* to cover fraudulent acts would be contrary to the doctrine of 'limited scope' of discharge, which was established to protect the company' interests from certain undesirable effects of such a waiver of rights.[148] Moreover, in the specific case, where a company employs

145. Supreme Court, 8 July 1991, ECLI:NL:HR:1991:ZC0316, par. 3.2.2, *NJ* 1991/765 (*Hoeben v. Noord Nederlandse Metaalhandel*).
146. Supreme Court, 8 July 1991, ECLI:NL:HR:1991:ZC0316, *NJ* 1991/765 (*Hoeben v. Noord Nederlandse Metaalhandel*).
147. See the conclusion by A-G Timmerman, 25 June 2010, ECLI:NL:PHR:2010:BM2332, par. 3.8 (*De Rouw v. Dingemans*).
148. Supreme Court, 10 January 1997, ECLI:NL:HR:1997:ZC2243, par. 3.4.1 (*Staleman v. Van de Ven*).

other employees in addition to the director and bears obligations to creditors, it is difficult to ever accept that such discharge could pertain to intentional fraudulent acts detrimental to the interests of the company and the company's stakeholders, despite the full knowledge of those who were authorised to grant the director discharge. Accordingly, the Supreme Court might or would likely have ruled that, contrary to De Bruin in *Ellem Beheer 2.0*, De Rouw sr. in *De Rouw 2.0* could not rely on the discharge pursuant to art. 2:8(2) DCC.[149]

4.5 Discussion

4.5.1 Perspectives on judicial review of discharge claims

In this research, empirical findings revealed that Dutch courts tend to prevent a waiver of rights from protecting directors acting in subjective bad faith.

To understand why Dutch courts tend to prevent a discharge from pertaining to the 'subjective bad faith' actions of directors, I have provided two perspectives on the 'limited scope of discharge'. The first perspective is the more common perspective and requires examination of the logic of 'known action' when reviewing discharge claims (paragraph 4.3.1). The second perspective, in which I took the empirical findings in paragraph 4.3.2 as the starting point and reinterpreted *Ellem Beheer* and *De Rouw*, considers the contextual circumstances of a case and takes a director's 'subjective good faith' to serve as a guide for reviewing discharge claims. In the second perspective I adopted 'known' action

149. As a side note, the sole condition that a director intentionally harmed the company, does not automatically mean that the director's reliance on the discharge is unacceptable according to the standards of reasonableness and fairness, as was decided in *Ellem Beheer*. In *De Rouw* there were however no exceptional circumstances that could justify the director's reliance on the discharge. Compare the Court of Appeal's judgement after referral, albeit in a different context involving a loan secured by a pledge (Court of Appeal 's-Hertogenbosch 27 October 2015, ECLI:NL:GHSHE:2015:4345, par. 3.5). The agreement was found to be null and void as it contained an immoral purpose: to maintain the liquid assets beyond reach of creditors. After referral, the Court of Appeal reviewed whether the derogatory effect of reasonableness and fairness could prevail, in the sense that the statutory rule (the penalty of voidness pursuant to art. 3:40(1) DCC), should be inapplicable given the circumstance that the invalidity of the agreement would be unacceptable according to the standards of reasonableness and fairness. The appellant was however unsuccessful in demonstrating that the respondents in the case acted fraudulently and could not rely on the voidness of the agreement.

as one important circumstance, allowing other relevant circumstances to play their part. Building on the second perspective, I will now discuss why it is desirable to expressly understand the doctrine of 'limited scope' in relation to a director's 'subjective good faith' as a baseline, a practice that I argued is currently implied in case law.

4.5.2 Directors' subjective good faith as a baseline for the review of discharge claims

Delaware's exculpatory statutory provision is a response to excessive litigation against directors throughout the United States. Section 102(b)(7) DGCL is therefore qualified by an exhaustive list of non-exculpable behaviours. The list functions to assist and instruct courts about instances when it is legitimate to dismiss a claim and effectively and efficiently terminate litigation. Director's 'subjective good faith' serves as a baseline and obliges Delaware courts to infer director's 'bad faith' when declaring a claim non-exculpable.

In contrast, as I have mentioned in paragraph 4.1.3, the litigation rate in the Netherlands is rather moderate and may not presumably need any legislative response. Dutch courts have the appropriate latitude to interpret discharge provisions in the light of the case at issue. Since a specific regime of company law is not available to review discharge claims, the Dutch Supreme Court based his review on the principles of general contract law and developed a doctrine of 'limited scope'. This has resulted in the adoption of the rationale of 'known' action as a baseline for the review of a director's claims to discharge. Under a doctrine of 'limited scope' strictly dependent on the rationale of 'known' action, a director's 'subjective good faith' is an irrelevant factor. As I have concluded in paragraph 4.3.3, this narrow perspective of 'limited scope' should belong to the past. I have proposed an alternative review of discharge claims by rethinking the legal reasoning in *Ellem Beheer 2.0* and *De Rouw 2.0.* Within the alternative judicial review of discharge claims, the doctrine regarding the 'limited scope of discharge' can be further developed so that the 'subjective good faith' of directors is made a further criterion. The conceptual framework is visualised in Figure 5.

Figure 5. Directors' 'subjective good faith' as a baseline

In the alternative method of reviewing discharge claims, the 'subjective good faith' of directors is considered the essential criterion under article 3:40 DCC. The requirement of 'subjective good faith' may subsequently be corrected, given the circumstances of the specific case at hand, by means of article 2:8 DCC. Important circumstances may include the fact that, although the director defrauded the company with the full knowledge of the shareholders' meeting, it was nonetheless in the interest of the company to discharge the director from directors' liability against payment of a settlement amount. For some companies, discharge may, under certain circumstances, be one critical instrument to expeditiously be rid of a malfunctioning director and return the focus to business.

Accordingly, this alternative, a contextualised form of reviewing discharge claims assumes 'known' action and the company's interest both to be important (but not exclusive) factors that, as exemplified in *Ellem Beheer 2.0* and *De Rouw 2.0.,* could further qualify the requirement of directors' good faith.

In my view, the present judicial method of reviewing discharge claims should be subjected to critical discussion wherever doctrine and empirical findings stand in contrast. Taking due account of the limited number of discharge claims that may have influenced court decisions, the observation that Dutch courts shield directors from liabilities arising from 'subjective bad faith' would seem to have little basis. There is, evidently, little reason to keep Dutch courts hostage to a legal misapprehension about the acceptability of shielding directors from personal liability to the company when the directors act in 'subjective bad faith'.

To correct the misapprehension, I advocate a statutory discharge provision within the boundaries of good morals and public order. Such a statutory provision would make 'subjective good faith' of directors an explicit condition for granting a director discharge from potential personal liabilities. Under the proposed statutory regime, 'subjective bad faith' actions are thus principally excluded from the scope of discharge. Only under exceptional circumstances may a court find the statutory provision inapplicable. One such situation may arise when a company's general shareholders' meeting is fully knowledgeable of the director's deliberate harmful acts, yet the parties agree to a settlement and as part of the agreement discharged the director for the litigious actions. Under these conditions it seems conceivable and consistent with *Ellem Beheer 2.0* and *De Rouw 2.0* that the director concerned should be able to rely on the discharge granted to him or her pursuant to art. 2:8 DCC. Moreover, under the specific conditions, it would seem a wise policy to allow a company to use discharge to efficaciously part with the director in the interest of the company. Discharge may then serve a reasonable company interest.

4.5.3 Limitation of the research

It should be recognised that the research findings and the suggestions made in this Chapter 4 to revamp the Dutch concept of discharge have certain limitations. I will discuss the following critical issues.

4.5.3.1 Validity of the research

In this research, I have argued that it is a hypothetical possibility for a Dutch court to apply a discharge provision and exempt a director from liability for 'subjective bad faith' actions and not that this has actually happened. I have based this argument on an examination of 11 coded sample cases involving discharge claims by directors in which courts have reached judgements to hold the respective directors personally liable or to release them from such liability. As I have attempted to point out in paragraph 4.1.3, this sample should be regarded as a non-probability sample. It is a subset that was constructed to serve the very specific purpose of discovering whether Dutch courts allowed discharge claims to cover bad faith actions and, if so, why or why not. The research

findings thus cannot be generalised to a larger population. A new Supreme Court decision involving the review of discharge may upset the analysis and propositions made in this chapter. Taken due account of the limited number of cases under study, the results and conclusions in this research should be viewed with appropriate reservations.

4.5.3.2 Recognising the historical roots of Dutch discharge

The findings in this research prompt us to critically reconsider the existing doctrine on discharge based on the informed legal act of waiver. I have argued that the basis of the existing doctrine is problematic. Such a claim may be further supported by recognising the historical context of the Dutch concept of discharge.[150]

Historically, directors were considered agents of the company.[151] The managerial duties of these agents were contractually constrained by mandate. In carrying out the mandate, the agent concerned was obliged to account for his actions to his principal. These accounts served to inform the principal of the performance of the agent under the mandate. The *informed* principal then could decide to approve the accounts. In approving the accounts, the principal assumed the agent's proper performance of his management duties and the agent concerned may assume he was freed of personal liability to the company. At least, the agent may assume that the principal had waived his right to sue the agent.[152]

Directors are no longer considered to be agents constrained by contractual obligations. The directors' scope of activities have broadened drastically and their authority has become institutionalised.[153] Dutch directors under the articles of association primarily derive their powers from company law. As of

150. It must be noted that I have not conducted a thorough historical analysis. Some general historical reflections may however provide better understanding of the Dutch concept of discharge.
151. Bier 2006, p. 39-40.
152. The link between the approval of the accounts and the discharge of directors' liability – providing the performance of management duties were discernible in the approved documents – was established in the Supreme Court decision in *Deen v. Perlak*. To date, pursuant to art. 2:101/210(3) DCC, the adoption of the financial statements by the general shareholders' meeting does not imply a discharge of liability of the directors or supervisory directors. A separate discharge resolution is required.
153. With reference to the legal decisions in *Forumbank* and *Doetinchemse IJzergieterij*, De Jongh describes the change in view of the legal relationship between the actors within the company as being purely contractual to regarding the company as a legal order in which the powers over the company are divided between the actors of the company (2014, p. 341). According to De Jongh (p. 340), the institutional view of the company already found support in the Supreme Court's decision in 1964 (*Mante*).

1 January 2013, the Dutch Civil Code prescribes that the directors shall discharge their duties in the interests of the company and its enterprises.[154] These legal developments may be seen as favouring a further institutional theory of the company in which pluralism of interests is prevalent.[155] In view of the codification of art. 2:129/239(5) DCC, it is assumed that, within the spectrum of the pluralism of interests, the company may have an interest in its own continuity. The argument in favour of the continuity of the company as a common corporate interest may lie in the growth or scale of the company's enterprise and the interests of employees and (to a certain extent) creditors with regard to the continuity of the company and its enterprise.[156]

Against the backdrop of the development of the company as an independent institution with its plural interests, it may seem more appropriate to further institutionalise discharge and to improve it as a 'corporate' instrument. As I have suggested, such an improvement should involve a director's subjective good faith as a requirement. Admittedly, a discharge, as it is now being perceived in legal doctrine, may have legal effect only between the director concerned and the company (the contracting parties), yet this legal fact does not exclude the interests that other (third) parties may have in the company's decision to provide discharge to a director. As a contracting partner acting within the context of the corporate legal order, the company should maintain cognizance of its own interests, including the interests of the employees and creditors of the company, and the company's independent interest with regard to the discharge resolution. At least, such a discharge should not be detrimental to the company's interests. The requirement of a director's good faith may be used for this purpose.

4.5.3.3 Annual discharge and final discharge

In paragraph 4.3.1, I have distinguished annual and final discharge. In my view, as a principle, annual discharge *and* final discharge should both be subjected to the requirement of directors' subjective good faith. Empirically, there is no reason why annual discharge and final discharge should – in the absence of exceptional circumstances – be treated differently as regards directors' subjective bad faith actions (see paragraph 4.3.2). At first sight, the empirical finding would appear to stand in contrast with existing case law. This need not be the case.

154. Article 2:129/239(5) DCC.
155. De Jongh 2014, p. 338 (explaining how the rise of the institutional theory of the company is closely related to the development of the corporate interest).
156. De Jongh 2014, p. 297-298.

When reviewing the casuistry of *Ellem Beheer* (in which final discharge was the object of review) and *De Rouw* (in which annual discharge was the object of review), the heated debate in my view, was not whether the director concerned did or did not acted fraudulently. Instead, it was debated that, even if a director acted (or were to act) in subjective bad faith, there may be relevant circumstances that, given the context, could be persuasive enough to nonetheless assign legal effect to the discharge resolution at issue. Compared to *De Rouw 2.0*, it seems that, in *Ellem Beheer 2.0*, the Supreme Court put weight on the shareholders' informed legal act of discharging the director concerned when judging the legal effect of the final discharge. Moreover, it can be argued that despite shareholders' knowledge of directors' subjective bad faith, the company is best served to provide a director final discharge as part of a settlement agreement in the attempt to get rid of the director concerned in order to get business back on track (see paragraph 4.5.2). The weight of judicial review concerning the legal effect of the annual discharge in *De Rouw 2.0*, was put on the company's interest instead of the director's interest. The discharge could not be applied to such apparent malicious actions, even though the director/shareholder concerned must have carried the knowledge of these actions. I am inclined to argue that if 'subjective good faith' would be adopted as the lens to review discharge claims, there would be more room for courts to consider relevant circumstances in order to reach better motivated decisions to validate discharge even in the face of directors' intentional harmful acts.

4.6 Concluding remarks

In this research, I have focused on the outer boundaries of the protection offered by the Dutch concept of discharge in shielding serious reproachable director conduct from liability by invoking comparative and empirical insights. Based on the comparative and empirical interpretation of case law, I came to the conclusion that, when considering the protection provided by a waiver of rights, a director's 'subjective good faith' serves as a baseline, either explicitly (in Delaware) or implicitly (in the Netherlands). With specific reference to the Netherlands, I proposed that within the doctrine of limited scope, the validity of the discharge should depend on two legal tests: (1) good morals and public order and (2) reasonableness and fairness. This interpretation favours a contextualised review of discharge claims in which a director's 'subjective good faith' constitutes a basic requirement for granting a discharge legal validity. I argued that it is preferable to explicitly indicate the essential nature of 'subjective good faith' by means of a statutory provision in order to better promote good corporate governance. At present, there is a belief that Dutch courts shield directors from personal liability even when they act in 'subjective bad faith' as long

as these litigious actions were ‘known’ to a company’s general shareholders’ meeting. It is time to disparage such beliefs and further conceptualise the notion of discharge in the light of good corporate governance.

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Chapter 5. Closing

The purpose of this dissertation was to explore the potential of directors' liability as a mechanism for controlling the behaviour of directors. Recognising the various dimensions of directors' liability and concepts of directors' discretion and marginal judicial review to control directors' behaviour (see Chapter 1), I studied directors' liability as a system of sanctions and protections impacting on Dutch corporate governance. I identified three areas of research: 1) defensive behaviour among company directors; 2) serious reproach as the analytical framework for reviewing director's liability in the context of art. 2:9, 6:162 and 2:138/248 DCC; and 3) directors' 'subjective good faith' as a basic condition for valid discharge claims. Within these three research areas, I considered directors' liability from the perspective of implicit and explicit sanction and protection measures. The findings, conclusions and propositions for improving the legal framework can be read in Chapters 2, 3 and 4. In this closing of the book, I aim to give some final reflections on how the research findings relate to existing debates and developments regarding directors' liability.

5.1 Convergence in judicial review through the open norm of 'serious reproach'

In studying directors' liability as a system for controlling directors' behaviour, I have emphasised the role of the civil courts in the corporate governance arena. Directors' discretion and marginal judicial review are important issues of Dutch corporate governance. Within the domain of directors' liability, these concepts are reflected in the liability standard of 'serious reproach'. The functions of 'serious reproach' for Dutch corporate governance are threefold. 'Serious reproach' first contributes by informing directors and those having interests in the company and directors' actions about the course of action by directors that is valued or should be avoided and provides a view of the enforcement mechanism. Unless actions are qualified as being subject to 'serious reproach', a director cannot be held liable. It follows from the foregoing that the second function of 'serious reproach' is to provide directors protection against excessive liability risks.

The protection provided can be found in the criterion of 'serious reproach' itself.[1] Thirdly, the presence of 'serious reproach' induces the courts to review the actions of directors marginally by providing them with relevant perspectives through which they may regard a director's personal liability in a given case.

'Serious reproach' is a product developed, specified and maintained by case law and, as I have demonstrated in my research, an important contributor to Dutch corporate governance. It is therefore not surprising that 'serious reproach' plays a key role in ongoing debates and academic reflections. Since the Supreme Court has explicitly extended the application of 'serious reproach' to the area of external directors' liability, there has been a great deal of debate involving the usefulness, necessity and desirability of focusing the marginal judicial review through this lens.[2] It is my impression that underlying these debates are concerns about legal uncertainty that such converging but variable practices of judicial review may bring about.[3] On the basis of the empirical findings in this research, I am inclined to argue that these concerns should be and can be appeased by the reality of judicial decision-making.[4] A substantive part of the litigation involving the liability of directors (37% of the 158 coded cases) ended with a court finding a director personally liable due to the 'subjective bad faith' of the director's actions. 'Subjective bad faith' actions are evidently subject to serious reproach, and are therefore a basis for directors' liability. Legal uncertainty was more at issue in the other (63% of the 158 coded) cases *not* involving directors' 'subjective bad faith'. Based on this research, it seems that the lens of 'serious reproach' mainly focuses on two factors, which appear to be influential and form a strong basis for judgment. They are: 'violations of norms' specifically addressed to the director and meant to protect the company or the company's creditors and shareholders, and directors' 'foreseeability of damage' to the company or the company's creditors and shareholders. I have noted that the occurrence of these factors in a given case provides sufficient evidence that a director, at the very least, did not act in good faith.

1. Supreme Court, 20 June 2008, ECLI:NL:HR:2008:BC4959, par. 5.3 (*Willemsen Beheer v. NOM*. See also Kroeze 2004, p. 375.
2. See for instance: Westenbroek 2015, p. 353-366 and Olden 2015, p. 367-369.
3. Westenbroek 2015, p. 366 for instance advocates concrete factors or circumstances that are relevant in addressing the question of when a director can be held personally liable to a third party of the company. The framework of 'serious reproach' seems to me to favour such finding of relevant factors and circumstances.
4. See also Pham (forthcoming).

5.2 Marginal judicial review and business judgement rule

Marginal review and the business judgment rule are methods limiting the substantive judicial review of directors' actions. The methods differ significantly however. The business judgement rule, as it is known in Delaware case law, is rooted in a history in which courts generally avoid substituting the judgment of a court for that of a skilful board of directors.[5] The business judgment rule therefore presupposes judicial 'non-review'.[6] Under the condition that the alleged director had no personal interest in the subject of the business decision, acted on an informed basis (demonstration of care) as well as in good faith and in the honest belief that the business decision was taken in the best interests of the company (demonstration of loyalty and good faith), directors enjoy the presumption of business judgment.[7] If these conditions are satisfied, directors' liability can only be assumed if the business decision lacks any rational business purpose (waste).[8] It has been argued that this rationality test effectively enables courts, in the absence of direct evidence of a director's lack of subjective good faith, to judge whether the business decision objectively lacked any rational business purpose.[9] When a business decision lacks rationality, the business judgment rule does not apply. On the other hand, if a claimant alleges and proves sufficient facts demonstrating that the duty of loyalty, care and/or good faith was violated, a breach of fiduciary duty removes a director's decision from business judgment protection and requires the director to show that the decision was entirely fair towards the company and its shareholders.[10] Substantive judicial

5. McMillan 2013, p. 526; Timmerman 2003, p. 557.
6. L.P.Q. Johnson, 2000, p. 625-652 (arguing that the business judgment rule is best understood as a 'narrow-gauged policy of *non-review* than as an overarching framework for affirmatively shaping judicial review of fiduciary performance.')
7. *Aronson v. Lewis* 473 A.2d 805 (Del. 1984).
8. *Brehm v. Eisner* 746 A.2d 244 (Del.2000).
9. Assink 2007, p.237. Hence a director's subjective good faith may be inferred based on objective clues of rationality.
10. *Emerald Partners v. Berlin* 787 A. 2d 85 (Del. 2001). Moreover, although most of the cases are decided under the business judgment rule or the entire fairness doctrine, Delaware courts have developed heightened standards of review where directors take defensive measures (see *Unocal v. Mesa Petroleum Co*. 493 A.2d 946 [Del. 1985]) or approve a change in control (see *Revlon, Inc. V. MacAndrews & Forbes Holdings, Inc*. 506 A.2d 173 [Del. 1986]). See for a comprehensive outline of Delaware's business judgment rule, entire fairness test and enhanced scrutiny test, B.F. Assink 2007, p. 246-365.

review is then justified. The court's review turns into an objective review of whether the decision was fair and reasonable. Accordingly, directors' decisions are typically protected and judicial deference warranted under the business judgment rule, unless there is a breach of duty or the decision constituted waste.

Judicial review of directors' conduct in the Netherlands involves marginal substantive review on the basis of an objective test. Within the objective test of directorial actions, Dutch case law requires judges to base liability analysis on all relevant circumstances.[11] Accordingly, under circumstances in which directors enjoy wide discretion (i.e. retain alternative courses of action), marginal judicial review is the proper mode of review. Likewise, where directors' discretion is limited or not at issue, it seems that there is less or no logic for marginal judicial review.[12] Indeed, I understand directors' discretion and marginal judicial review as intercommunicating vessels. Here is why.

As I have noted in the above, this research uncovered only few factors which were prevalent for assuming directors' liability: directors' 'subjective bad faith', 'violations of norms' which were specifically addressed to the director, and 'foreseeability of damage' on the part of the director. Under these conditions, the mode of judicial review is strict. Put differently, under these conditions, it seems likely that a director enjoys limited or no discretion and therefore may not rely on leniency in judicial review. Hence, within the Dutch legal framework and under the stated conditions, a director is likely and duly to be held personally liable. Moreover, it seems unlikely to me that, under these conditions and according to Delaware case law, a director could rely on the protection of the business judgment rule or would survive a rationality test or any other test mentioned in the foregoing. Where severe violations demonstrate that a director had not acted in good faith, it is very likely that courts will find a director liable, irrespective of the underlying method of judicial review.[13]

On the other hand, marginal judicial review is all the more the proper mode of judicial review in cases in which 'subjective bad faith', 'norm violation' and 'foreseeability of damage' are *not* at issue. For instance, the research findings also showed that 'unreasonable risk taking', director 'incompetence' or 'policy failure' had no significant impact on directors' liability. Dutch courts thus seem to respect directors' discretion in these areas of business judgment, or better said, afford directors business judgment. More concretely and as an example, a director may stay out of the danger zone and remain bona fide even if he took unreasonable risks, as long as other aggravating circumstances are not present.

11. Supreme Court, 10 January 1997, ECLI:NL:1997:ZC2243 (*Staleman v. Van de Ven*).
12. See also Assink 2007, p. 53.
13. Kroeze 2005, p 18 (advocating, in the context of 2:9, judicial non-review proceedings in the Netherlands, under the condition that a claimant sufficiently demonstrates that a director's action was not in good faith and not in the interest of the company).

5.3 Bona fide directors should not fear directors' liability

I was fortunate to be able to speak with bona fide directors for the purpose of this research. As my research showed, directors' liability is a concern for bona fide directors. On the basis of the research, it cannot be excluded that directors' liability risks may place these directors in a defensive mode of behaviour. I have argued however that this mode of behaviour is not necessarily undesirable. Delaying decisions, avoiding high risk markets or industries, requiring additional research, decentralising decision-making, being attentive, minutely documenting board decisions and discussions, firing executive directors prematurely to avoid further escalations, wanting to learn every detail about a fellow director, in particular the CEO and the board's president, requiring a company to provide the best protection possible and more, are perhaps useful and prudential practices. One needs a level of control to be able to trust and to tolerate threats of liability with a view to risk taking.

Among others, bankruptcy was considered a source of threat. In this research, the large portion of directors' liability litigation involved bankrupt companies (85% of the 158 cases). Thus, directors' liability threat perceptions were not unjustified. I like to reassure bona fide directors somewhat with the following: in the research I found that bankruptcy was not a significant factor for courts to assign or reject directors' liability. This brings me to the view that it is important for courts to provide clear and transparent communications about the circumstances in which a director does and does not incur liability. This is particularly important when considering that, in the majority of the cases, directors were found liable by reason of subjective bad faith (see Chapter 3, Figure 1).

One particular issue of poor transparency and lack of clarity involves the treatment of discharge in Dutch case law. In this research, I viewed discharge in the light of corporate governance. Although I recognised that discharge may effectively function to allocate the economic risks of a director's action to the company, in this research I was primarily interested in exploring discharge as an instrument for controlling director's behaviour. This led me to concentrate on the limited scope of discharge and its ability to exempt directors from the consequences of their bad faith actions. The empirical findings showed that there was no single case in which a director was not held liable for acting in 'subjective bad faith'. This finding stands in contrast with existing doctrine and literature, which suggest that a director may be discharged of personal liability for intentional harmful actions towards the company as long as these litigious actions were 'known actions' to a company's general shareholders' meeting.

Supported with insights from Delaware case law, I have noted the benefit of placing the Dutch concept of discharge within the broader framework of directors' liability in which 'subjective good faith' constitutes a basic condition. I have advocated that requiring the 'subjective good faith' of directors in the context of discharge constitutes good corporate governance. Moreover, the 'subjective good faith' of directors when undertaking action in the interest of the company may form a better foundation on which to base court decisions when a court is inclined to invalidate discharge because it pertains to actions in 'subjective bad faith'.

Finally, the interviews with bona fide directors also provided indications that directors are generally receptive to norms and duties requiring that they act in good faith. In this respect, I also believe that it is poor corporate governance for a legal system to communicate ex-ante that its courts will respect discharge provisions shielding actions in 'subjective bad faith', provided that these bad faith actions were 'known' to shareholders. Such communication is not good marketing for bona fide directors or good corporate governance. If 'subjective good faith' is assumed to be the baseline, 'known action' may be a means by which, under exceptional circumstances, a discharge regarding a director's actions in 'subjective bad faith' may be upheld on the basis of art. 2:8 DCC. In the end and without being overly naïve, the best protection a director may have is to act in good faith and in the best interest of the company, and not to indulge in excessive self-protection.

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Summary

This dissertation adopts directors' liability as a system of sanction and protection. Directors' liability was examined in the light of corporate governance with emphasis on the potential of personal liability to control directors' behaviour.

The dissertation consists of three research papers. The first research paper (Chapter 2) covers the issue of directors' perceptions of directors' liability. The central research question focusses on the relation between directors' perceptions of liability and defensive behaviour. The research findings could not give conclusive answers. However, the research findings do clarify that directors are rather uncomfortable with facing uncertainty. Directors are not only unaware of the actual liability risks, they are also uninformed about the standards of liability. The research suggests that an attempt should be made to provide directors with an understanding of the prevalent standards with regard to directors' liability.

The second research paper (Chapter 3) covers the issue of predictability of court decisions. The central research question focusses on whether the open norm of serious reproach invites or reduces uncertainty. Qualitative and quantitative analysis of court decisions involving directors' liability were combined to develop a probability model and to identify the most relevant factors underlying a court's decision to assign or reject directors' liability. A sample of court decisions was coded for the purpose of the quantitative analysis. Based on the factors identified in the research, serious reproach was formalised as follows: a violation of a norm specifically addressed to the director pertaining to protect the company or the company's creditors or shareholders is a prerequisite for assuming serious reproach. The research shows that based on the sample of court decisions under study, courts reach decision fairly consistently.

The third and final research paper (Chapter 4) covers the issue of discharge of directors for intentional harmful acts against the company by means of an informed shareholders' resolution. The paper raises the question of why it is problematic that the existing legal doctrine on the limited scope of discharge [beperkte reikwijdte van de décharge] does not mention directors' subjective good faith as a requirement for discharge from personal liability to the company. In response to the research question, discharge was examined as a corporate governance instrument. Comparative and empirical insights show that there is no reason why courts should not require directors' subjective good

faith as a condition to validate discharge. This, however, entails a different lens to review discharge claims. It is proposed in the paper to replace the rationale of shareholders' informed discharge decision as the basis for discharge with directors' subjective good faith. Directors' subjective good faith is argued a more preferable rationale for discharge in the light of good corporate governance.

Samenvatting

In dit promotieonderzoek is ervoor gekozen om bestuurdersaansprakelijkheid te bestuderen in het kader van behoorlijk ondernemingsbestuur (corporate governance). De nadruk is gelegd op de gedragsbeïnvloedende kant van bestuurdersaansprakelijkheid.

Het onderzoek kent drie onderzoeksblokken met als resultaat een dissertatie bestaande uit drie research papers. De research papers zijn zodanig opgesteld dat zij onafhankelijk van elkaar kunnen worden gelezen. De rode draad van de dissertatie is dat bestuurdersaansprakelijkheid als systeem van sanctie en bescherming wordt gezien.

De eerste research paper (Chapter 2) gaat in op de perceptie van bestuurders van aansprakelijkheidsrisico 's. De centrale vraag van de paper is of bestuurders bang zijn voor aansprakelijkheid en of de vrees voor aansprakelijkheid tot onwenselijk defensief gedrag leidt. Daarvoor is een casestudie uitgevoerd onder top-level bestuurders. De research paper geeft geen concluderend antwoord op de vraag of bestuurders bang zijn voor aansprakelijkheid. Wel geeft de paper aan onder welke condities bestuurders het aansprakelijkheidsrisico als reëel en bedreigend ervaren en wanneer aansprakelijkheidsrisico 's potentieel defensief gedrag zouden kunnen uitlokken (fraude, faillissement en een eerdere persoonlijke ervaring met aansprakelijkheid). Ook geeft de research paper geen concluderend antwoord op de vraag of de vrees om aansprakelijk te worden gehouden tot onwenselijk defensief gedrag leidt. Wel geeft de paper aan dat bestuurders zich zeer ongemakkelijk voelen wanneer zij geconfronteerd worden met onzekerheid over aansprakelijkheidsrisico 's en dat zij deze onzekerheid zoveel mogelijk willen reduceren. Niet alleen weten bestuurders niet wat de werkelijke aansprakelijkheidsrisico 's zijn, zij zijn evenmin geïnformeerd over wat de aansprakelijkheidsnormen zijn bij een eventuele formele bestuurdersaansprakelijkheidsprocedure.

De tweede research paper (Chapter 3) gaat in op de voorspelbaarheid van rechterlijke uitspraken inzake bestuurdersaansprakelijkheid. De centrale vraag van de paper is of de open norm van ernstig verwijt onzekerheid uitnodigt of juist reduceert. Om die vraag te beantwoorden is een kwalitatieve en kwantitatieve analyse van rechtspraak bestuurdersaansprakelijkheid uitgevoerd. De research paper onderscheidt minder complexe en complexe zaken. De minder complexe zaken waren zaken waarbij de rechter oordeelde dat er sprake was van

subjectieve kwade trouw handelingen van de bestuurder, dat wil zeggen, opzettelijk benadelend handelen ten opzichte van de vennootschap en/of de crediteuren of aandeelhouders van de vennootschap. Onder die omstandigheid oordeelde de rechter de bestuurder aansprakelijk. Andere omstandigheden leken bij deze zaken niet veel toe te voegen aan het oordeel van de rechter. De complexe zaken waren zaken waarbij het bestuurlijk handelen niet te kwalificeren viel als subjectief kwade trouw handelingen en waarbij het rechterlijk oordeel kon resulteren in toewijzing of afwijzing van bestuurdersaansprakelijkheid. In deze complexe zaken speelden meerdere contextuele omstandigheden wél een rol. In de research paper wordt aangegeven welke contextuele omstandigheden een grote voorspellende waarde hebben voor aansprakelijkheid. Op basis van het inzicht in deze relevante contextuele omstandigheden kan ernstig verwijt thans als volgt worden geformaliseerd: het schenden van een specifiek voor een bestuurder geldende norm die beoogt de vennootschap, de crediteuren of de aandeelhouders van de vennootschap te beschermen, is een noodzakelijke voorwaarde voor het aannemen van ernstig verwijt.

De derde research paper (Chapter 4) gaat in op het verlenen van décharge aan bestuurders voor subjectieve kwade trouw handelingen. De centrale vraag van de paper is waarom het problematisch is dat de doctrine voorschrijft dat een geïnformeerde algemene vergadering van aandeelhouders een bestuurder mag dechargeren voor opzettelijk benadelende handelingen jegens de vennootschap. De vraag wordt beantwoord vanuit het perspectief van décharge als corporate governance instrument. Voor de beantwoording van de vraag zijn rechtsvergelijkende inzichten en empirische bevindingen gebruikt. Dit heeft geleid tot een andere manier van denken over décharge. De empirie laat tot nu toe zien dat rechters een halt roepen aan het déchargeren van bestuurders voor opzettelijk benadelende handelingen jegens de vennootschap. Wanneer de doctrine en de empirie wezenlijk tegenover elkaar staan, dient ten minste een kritisch debat te worden gevoerd, bijvoorbeeld over hoe décharge als corporate governance instrument kan worden verbeterd.

Ik pleit ervoor dat een bestuurder in beginsel niet kan worden gedechargeerd voor subjectieve kwade trouw handelingen, tenzij er exceptionele omstandigheden bestaan. De kennis van de algemene vergadering van aandeelhouders van de kwade trouw handeling van de bestuurder wordt anders dan volgens huidig recht niet gezien als van doorslaggevende betekenis voor décharge. Ik ben daarom voorstander voor een alternatieve zienswijze. Die alternatieve zienswijze houdt in dat een bestuurder een beroep kan doen op décharge mits hij – als ondergrens – subjectief te goeder trouw handelde. Onder omstandigheden kan – bij wijze van uitzondering op de hoofdregel – de redelijkheid en billijkheid meebrengen dat een bestuurder een beroep kan doen op décharge als

hij de algemene vergadering van aandeelhouders in kennis heeft gesteld van de opzettelijk benadelende handeling. Dit zal het geval zijn wanneer het vennootschappelijk belang gediend is bij een dergelijke décharge voor opzettelijke benadeling van de vennootschap.

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Curriculum vitae

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