

# Maxim Hodak discusses the pitfalls of directors' and shareholders' liability in the Dutch corporate law

*With the increasing popularity of entrepreneurship, the disadvantages and risks of running a business are often underestimated.*

EINDHOVEN, NORTH BRABANT, THE NETHERLANDS, July 21, 2022 /EINPresswire.com/ -- Directors' and shareholders' liability plays an important role in the success and failure of a company. Statistically, the number of bankruptcies in 2021 in the Netherlands was the lowest in 31 years. Experts say these numbers are skewed because of the government's emergency response and the court's tendency to make healthy companies less likely to file for bankruptcy. According to attorney-at-law Maxim Hodak of Law & More, fewer bankruptcies does not mean that the risks are now lower compared to pre-pandemic in view of the impending economic recession.

## HOW WOULD YOU EXPLAIN DIRECTORS' LIABILITY?

By law, a legal entity only exists on paper and needs a person who can act on its behalf. Therefore, legal entities are represented by a board that performs legal acts, such

as entering into contracts, acquiring property and debt, or initiating lawsuits. Directors bind the legal entities with these legal acts. Generally, directors of the Dutch private limited company (BV) are not personally liable for these acts and the consequences thereof with their private assets.

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*Maxim Hodak*

Naturally, there are exceptions to this rule when directors are accused of mismanagement of the company and held liable with their personal assets.

## WHEN ARE DIRECTORS PERSONALLY LIABLE?

The risk of personal liability always exists. Most

importantly, there are two types of directors' liability: internal and external. In the case of



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external liability, the director is responsible towards third parties such as suppliers and customers. Internal liability implies responsibility to the company (legal entity) itself for negligence or mismanagement.



The Dutch Civil Code defines mismanagement very broadly, assigning responsibilities such as activities performed, their nature, risks, division of tasks within the board and the administrative activity. The use of information that the director has or must have when making a decision or assesses the activity can also influence the outcome of the case. Activities that are in conflict with the articles of association can lead to serious consequences for the company and the director himself.

#### WHAT IS CONSIDERED AS MISMANAGEMENT?

The list of actions that could be considered mismanagement is extensive. This includes, for example, many actions and decisions that lead to financial mismanagement. Examples of such actions are the withdrawal of assets from the legal entity and their use as private assets. Another example is mixing private matters with corporate matters and competing with the legal entity. In particular, subordinating the interests of the legal person to private interests or interests of third parties. In addition, unauthorized binding of the legal person to third parties, taking unnecessarily large financial risks and decisions with far-reaching financial consequences can be regarded as improper management. Entering into transactions that significantly exceed the financial resources of the legal entity without proper preparation may be considered irresponsible and may lead to liabilities. In addition to financial consequences, neglect or non-occurrence of thin capitalization, debt accumulation, poor credit monitoring and insurance management can be seen as acts of mismanagement.

#### HOW CAN DIRECTORS DEFEND THEMSELVES?

The allegations of maladministration apply to the entire board which is fully liable under the law. In some cases, directors can 'excuse' (exculpate) themselves from this liability by proving that the accusations are wrongful. They must also demonstrate that they have not been negligent in preventing mismanagement.

Protesting against the policy pursued by the board will not be considered sufficient evidence. The director is expected to oppose any decision he/she does not support and to limit the consequences of maladministration. The director must record in writing that he has warned about possible negative consequences and describe the measures he has taken to prevent them. In some cases, directors may be forced to resign to avoid liability if the board ignores the warning.

Directors are expected to be well aware of all facts and circumstances when it comes to making decisions, especially those tied to financial management. He or she cannot escape liability

because of the division of tasks within the board. Only in some cases can they avoid personal liability for being misinformed.

#### WHEN DOES SHAREHOLDER LIABILITY APPLY?

Under Dutch law, shareholders can also be personally liable for their actions within a company. Personal liability can have major consequences for a shareholder's private life. It is therefore important to be aware of the risks arising from shareholder liability.

First of all, shareholders have three types of obligations: legal obligations, obligations arising from the articles of association and obligations arising from the shareholders' agreement. Shareholders are required by law to pay the company for the shares they acquire. In the event of bankruptcy, shareholders are obliged to pay all shares in full. The articles of incorporation may extend the liability of shareholders and require that he or she be held personally liable for the debts of the company.

Shareholders can be accused of wrongful acts by selling shares to third parties. Under certain circumstances, a shareholder can be held personally liable if he transfers his shares to a third party and this transfer results in the company being unable to pay its creditors.

In addition, shareholders can give the directors instructions that directors are obliged to follow, unless these instructions contradict the interests of the company or the articles of association. Nevertheless, shareholders are not allowed to assume the role of director. If they do act as directors, they are regarded as policy makers and treated as directors. This means that they can be held liable on the basis of directors' liability if, for example, the company goes bankrupt.

Although a company is liable for damage resulting from its actions, directors and shareholders are personally liable in certain situations. Failure to comply with legal obligations and wrongful acts can lead to liability of directors and shareholders with their personal assets. Shareholders are obliged to adhere to the articles of association and the shareholders' agreement. In some cases, shareholders unconsciously act as directors and thus run the risk of directors' liability themselves. To limit risks, it is essential to consult a lawyer in due time.

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