

## Company & Commercial - Netherlands

In a nutshell - one-tier boards

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April 10 2012

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### Introduction

The Upper House of Parliament has adopted an act on one-tier boards which amends the rules on management and supervision within private companies with limited liability (BV) and public companies with limited liability (NV). The act is likely to come into effect on July 1 2012.

The act provides for fundamental modifications in board structure within BVs and NVs. The most substantial alterations include the legal basis for the one-tier board system and an amendment to the conflict of interest rules. The act also imposes limitations on the number of positions for members of company boards, introduces target figures for achieving gender diversity on company boards and adjusts the legal status of management board members of listed companies.

### One-tier board

#### ***One-tier and two-tier system***

The Civil Code currently provides only for a two-tier board system. Within this system, the management board and the supervisory board exist side by side and the supervisory board supervises the management board.

The act includes an alternative to the existing two-tier board system. A company's articles of association can provide for a one-tier board on which both executive and non-executive members sit. The executive members are responsible for the company's daily management, whereas the non-executive members supervise the executive members. All board members are responsible for the company's general course of affairs.

By introducing the legal basis for a one-tier board, the Dutch regime has been brought into line with that of several other western European countries. Although the one-tier system is common in the United States and the United Kingdom, and the two-tier system in Germany, Austria, Denmark and Finland, both systems exist in Belgium, France, Portugal, Spain – and soon in the Netherlands. A main characteristic of the one-tier board system is that the non-executive board members receive more information at an earlier stage than supervisory board members would receive in the two-tier system. This will affect the liability of non-executive board members.

#### ***Characteristics of the one-tier system***

If a company opts for a one-tier board system, this must be laid down in its articles of association. Subsequently, the allocation of duties between the board's executive and non-executive members can be set out in or pursuant to the articles of association. Such an allocation of duties can also be made in a separate document, if permitted under the articles of association. The shareholders' general meeting is competent to appoint both executive and non-executive board members, except where the company is subject to the so-called 'structure regime'. This applies – broadly speaking – to large companies. Non-executive members are then appointed at the shareholders' general meeting; non-executive members, in turn, appoint the executive members.

The legislature has restricted the freedom to allocate duties on several points. For example, non-executive members cannot be deprived of the right to supervise the executive members of the board and the chairman of the board must be a non-

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executive member. This means that a chief executive cannot be appointed as the chairman of a one-tier board.

### **Responsibility and liability**

Since all board members are responsible for the company's general course of affairs, the principle of collective responsibility will continue to apply. Based on Article 2:9 of the Civil Code, each management board member will remain responsible for the performance of the board's duties and can be held liable for mismanagement if those duties are not enacted properly. An individual board member can avoid liability if he or she proves that the alleged mismanagement was not attributable to him or her, and that he or she was not negligent in acting to prevent its consequences. Accordingly, it seems prudent to capture the allocation of tasks between board members accurately.

Each management board member remains responsible for the fulfilment of duties and the decisions made by the board. There is a difference, however, between the liability of non-executive members in a one-tier board system and that of supervisory board members in a two-tier system. In a one-tier system, non-executive members participate in the decision-making process regarding daily affairs; hence, they are involved in the company's policy making. This is in contrast with supervisory board members in a two-tier board system. As a result, a non-executive member in a one-tier system runs a higher risk of being held responsible for his or her actions as a board member.

Despite the principle of collective responsibility, the decision making of a one-tier board is not always collective. The articles of association can stipulate that one or more board members have the authority to decide within their specific area of competency. This delegation of tasks and authority to make decisions is a novelty and applies only in case of a one-tier board system. An autonomous decision is considered to be a decision of the entire board. Given collective responsibility, it seems advisable (although not required by law) to inform other board members of any decisions made. Such an obligation to notify can be included in the articles of association or in a simple board regulation document.

### **Conflict of interest**

According to current Dutch law, a management board member may not represent the company if he or she has a conflict of interest with the company, in the absence of a provision to the contrary in the articles of association. This provision concerns the authority to represent the company and the external enforceability of a conflict of interest. The act abandons this approach: a conflict of interest will, in principle, affect the company's internal decision making only. Under the new rules, neither a management board member nor a supervisory board member may participate in any deliberations or decision making involving a subject or transaction in relation to which he or she has a direct or indirect interest that conflicts with the interests of the company and its enterprise. If, in a two-tier board system, the management board is unable to take a decision due to a conflict of interest on the part of one or more of its members, the decision must be taken by the supervisory board. If there is no supervisory board, the decision must be taken by the shareholders' general meeting, unless the articles of association provide otherwise. The new scheme is focused on decision making instead of representation. This simply increases legal certainty.

A decision that is taken by a management board member with a conflict of interest is voidable. This has no external effect, unless the management board member misuses his or her authority and the other party knew of this conflict of interest. The board member acting with a conflict of interest against the company may be liable because of improper conduct of duties. Given the board's collective responsibility, the other (non-) executive board members may also be liable unless, in view of the allocation of duties, no serious reproach can be attributed to them and they were not negligent in taking measures to reduce the impact or avert improper management.

### **Limitation of board positions**

The act also provides for a maximum number of positions that may be held by management board members or supervisory board members of large companies. A company will be regarded as 'large' if at least two of the following qualifications apply:

- The value of the assets according to the balance sheet with explanatory notes exceeds €17.5 million;
- The net turnover exceeds €35 million; and
- The average number of employees equals or exceeds 250.

Foundations with a cultural, religious, scientific or charitable purpose are excluded from the scope of this part of the act. This also applies to group companies, cooperatives, associations, mutual benefit associations and foreign legal entities.

A management board member of a large Dutch company will be prohibited from holding more than two supervisory positions at another large Dutch company. A 'supervisory position' is a position as:

- a supervisory board member;
- a non-executive board member; or
- a member of another type of supervisory body which is instituted pursuant to the articles of association.

These management board members cannot be appointed as chair of a supervisory board, one-tier board or any other type of supervisory body. Supervisory directors will also be prohibited from holding more than five supervisory positions, whereby chairmanship of the relevant board or supervisory body will count as two supervisory positions. The act must be applied at the time of an appointment. Hence, a later change in circumstances does not affect an appointment that was valid when made. It can, however, affect reappointment. Any appointments made in violation of this rule must be considered void.

### **Gender diversity**

A further aim of the act is to increase the number of women participating in the management boards of large companies. Following the example of countries such as Spain and Norway, the act provides for a rule that large companies should strive for a balanced allocation of seats on the board (and the supervisory board in a two-tier system) between men and women. This is the case if at least 30% of the seats are occupied by women and at least 30% by men.

If a company fails to meet these targets, it must explain in its annual report why it has failed to do so, how it attempts to meet the targets and what it intends to do in the future in order to meet the targets ('comply or explain'). The measure will expire on January 1 2016. The impact of this rule will have to be evaluated in order to decide whether it should be extended.

### **Legal status of management board members of listed companies**

According to the act, management board members of listed companies will no longer enter into an employment agreement with the relevant listed company (Article 7:610 of the Civil Code), but will rather enter into a service contract (Article 7:400 of the Civil Code). This implies that board members of listed companies will no longer be protected under employment law. Employment contracts that are already in place on the date of the act's enactment will continue to be respected.

The rationale for this change is that, currently, a departing management board member may not receive a severance payment in excess of one year's salary. This principle, laid down in several corporate governance codes, including the Corporate Governance Code, is often traversed. The change under the act is aimed at controlling the level of severance pay to failing board members. The question arises whether this arrangement is appropriate or effective, since a service contract can also include agreed-on severance arrangements.

### **Comment**

With the introduction of the one-tier board system in Dutch company law, the Netherlands aims to connect with legislation in other western European countries. The legal basis provides for clarity and structure on certain aspects such as liability.

The new scheme for conflict of interest used in the act emphasises the internal decision-making process instead of the authority to represent the company. Although management board members with currently more than two positions, or supervisory board members with more than five supervisory positions, will undoubtedly find the act restrictive, the rule is a logical consequence of the one-tier board system. Non-executive board members are more involved in managing the company, which requires an active role.

With the balanced allocation of seats on the board between men and women, the legislature seeks to achieve a higher percentage of women in company board positions. This seems a desirable aim, but the question remains whether substantial change within five years will be seen.

With regard to the legal status of management board members of listed companies, it is doubtful whether this rule will achieve its goal. A contract for services has no prescribed form and directors will (continue to) negotiate aggressively.

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