INVESTING IN DUTCH COMPANIES

The Role of Dutch Corporate Law in Supporting U.S. Investors

Mr. E.J. (Ernest) Loor
Loor Legal & Partners

LOOR LEGAL
Advocaten voor ondernemers

This article examines the legal strategies at play in the regulation of (ordinary) business transactions and decisions in order to achieve optimal alignment between an investor and the board with the goal of increasing value for investors

1. Introduction

Investing in a company means entrusting your capital to others. As an investor, you'll rely on the company's board and its shareholders to act in your best interest. However, this can give rise to certain challenges, such as managing relationships and ensuring everyone's interests are aligned. These issues are often referred to as "agency problems".

In an investment round, there are, broadly speaking, two types of agency problems that can arise: vertical agency problems (between shareholders and the company's management) and horizontal agency problems (between common shareholders and preferred shareholders, with different financial and control rights).

Both U.S. and Dutch corporate law offer solutions to address these issues. In the following chapters, I compare U.S. and Dutch corporate law, illustrating the similarities and differences.[1] This highlights how Dutch corporate law allows U.S. businesses to invest in Dutch companies with confidence, while reducing transaction costs. Additionally, I will provide legal strategies to ensure solid business operations in the Netherlands.

---

2. Similarities Between Dutch and Delaware Corporate Law

Dutch and Delaware corporate governance systems share notable similarities, reflecting a broader trend in corporate regulation that seeks to balance the interests of investors and directors/entrepreneurs. In both jurisdictions, boards of directors play a crucial role in safeguarding the interests of shareholders while exercising discretion over the day-to-day operations of the company. Moreover, both systems provide shareholders with mechanisms to influence company decisions and governance.

Here's how both systems allow investors to protect their interests:

§ 2.1 Financial Rights

Investors often secure special contractual rights through convertible preferred shares. As in the United States, there are various forms of preferred stock, including common preferred stock and cumulative preferred stock. Additionally, preferred shares can be participating or non-participating, and convertible or non-convertible.

Common agreements in this regard (especially in venture capital investments) include:

- **Liquidation preference:** A liquidation preference ensures that before any distribution is made to holders of other shares, the investor receives a one-time return on an exit.
- **Convertible shares:** In the context of an investment, conversion often involves giving holders of convertible preferred shares the right to convert their shares into common shares, thereby waiving the liquidation preference. This gives investors the opportunity to choose between a fixed return and a share of the common shareholders' proceeds.
- **Participating or non-participating shares:** As in the U.S., investors can negotiate for participating and non-participating preferred shares. Non-participating preferred shares only provide the right to the agreed liquidation preference without conversion. Participating preferred shares, after receiving the liquidation preference, also entitle preferred shareholders to share in the proceeds if a certain threshold is met.
- **Anti-dilution rights:** To protect investors from events where shares are issued at a lower price than the investor paid (a so-called down round), anti-dilution rights can be negotiated. These rights are often covered by contract in shareholder agreements. As in the United States, there are different types of anti-dilution clauses, such as full-ratchet or weighted-average clauses[2], with the latter being divided into broad-based and narrow-based categories[3]. Other possible investor protections include preemptive rights[4] or, in exceptional cases, a veto right.
- **Redemption rights:** This ensures that investors can have their shares repurchased by the company at a pre-agreed price.

§ 2.2 Voting Rights

To further protect against risks, investors can negotiate specific voting and control rights, such as:

- **Shareholder's right to elect board members:** A common remedy to avoid vertical agency problems is an investor's right to appoint a director. To maintain control over their investment, investors in the Netherlands often stipulate this right. Another practice that has migrated from the United States is for investors to negotiate the right to appoint a board observer. A board observer is a person who does not formally serve on a company's board of directors (and thus has no voting rights), but is merely a listening ear. This right is typically outlined in shareholder agreements.
- **Shareholder information rights:** To reduce the risk of information asymmetry, investors can negotiate information rights. Under Dutch law, the management board and supervisory board must provide requested information to the general meeting of shareholders, unless it conflicts with the company's overriding interests. In addition, an investor can stipulate preferred shares to help prevent decisions based on hidden information. Entrepreneurs who accept preferred shares may signal that their company is worth more than the investor's liquidation preference.
- **Reserved matters:** The company's shareholder agreement or bylaws may list management decisions that require the prior approval of another body, such as the general meeting of shareholders. It can also be contractually agreed that certain management decisions need the prior approval of the investor.

- **Drag-along and tag-along rights:** A drag-along right allows an investor to require fellow shareholders to co-sell on an exit. A tag-along right allows an investor to require co-shareholders to include the investor's shares in a sale of shares held by other shareholders.

§ 2.3 Flexibility and Contractual Freedom

Delaware law provides significant flexibility and contractual freedom, allowing investors to meet complex contractual needs. Similarly, Dutch corporate law is fairly flexible for private companies, and specific rights and obligations can be accommodated in a company's articles of association. This dynamic enables corporate law to evolve in response to new challenges, creating a flexible regulatory environment that fosters investor confidence. As in the U.S., Dutch corporate law provides flexibility in corporate governance, which reduces risks and increases operational efficiency.

§ 2.4 Initiating Litigation

As in Delaware, the quality of justice in the Netherlands is high. Shareholder litigation typically occurs in inquiry proceedings before the Enterprise Chamber, a division of the Amsterdam Court of Appeal that specializes in corporate proceedings. Any shareholder, alone or acting jointly, who holds sufficient shares may initiate inquiry proceedings and request the Enterprise Chamber to appoint independent investigators to review the company's policies. The Enterprise Chamber may order an inquiry if there are reasonable grounds to believe that mismanagement has occurred. Mismanagement is a broad concept and can include conflicts of interest among board members, insufficient disclosure to shareholders, abuse of minority shareholders, or the unjustified use of takeover defenses. The Enterprise Chamber may order interim measures at any time during the proceedings.

---

3. Differences Between Dutch and Delaware Corporate Law

While the Dutch system has much in common with Delaware law, there are differences that U.S. investors need to be aware of when considering investments in the Netherlands.

§ 3.1 Division of Powers

Dutch companies can adopt a one-tier board (similar to Delaware, with executive and non-executive members) or a two-tier structure, which separates management and supervisory functions. The latter structure can complicate decision-making, as supervisory boards are primarily tasked with oversight, which can lead to a disconnect between the executive board, which manages the company, and the supervisory board, which supervises and advises the executive board. The two-tier system may seem more complex to U.S. investors, who are used to a single board model, but it offers additional checks and balances.

§ 3.2 Shareholder vs. Stakeholder Model

Delaware law operates on the premise that a company is managed based on a firm-specific model, meaning the corporation is run on the idea that the shareholders are investors in that corporation. The fiduciary duties owed by directors of a Delaware corporation (i.e. legal obligations of directors to act in the best interest of the company) require the directors to seek to maximize the value of the corporation over the long-term for the benefit of the stockholders as residual claimants to the value created by the specific firm that the directors serve. It does not mean striving to maximize value for diversified investors who own equity investments across all firms[5].

While Delaware law allows directors to consider the interests of other stakeholders, such as employees or creditors, the ultimate goal remains maximizing shareholder value. Directors may consider the interests of other stakeholders only as a means of promoting shareholder value. This premise does not preclude Delaware law from allowing companies to choose a model in which a company is managed for the benefit of diversified investors (for example, through a limited purpose clause in the company's bylaws).[6]

In contrast, Dutch Supreme Court case law dictates that the board, when fulfilling its duties as assigned by law or the company's articles of association, must prioritize the interests of the company and its affiliated enterprise, which includes shareholders but is not limited to them. Dutch law follows a firm-specific model[7], but shareholders are part of a wider circle of stakeholders whose interests the board must carefully weigh when serving the company's best interests. These stakeholders include employees, suppliers, customers, the public sector, and civil society. In any case, the board must also include the interests of an investor in its weighing of interests, but the circumstances of the case will determine how the corporate interest is colored, taking into account agreements made between shareholders and the general standards of reasonableness and fairness.[8]

This broader view of corporate responsibility means that, more so than under Delaware law, an investor's ability to use the company solely for personal gain is limited by the principles of board autonomy and reasonableness and fairness. These principles impose restrictions on the special contractual rights investors negotiate. American investors should be aware that the Dutch emphasis on broader social responsibility may influence corporate decision-making.

While this more subjective approach to stakeholder interests may introduce costs and uncertainty for venture investors, it also provides a safety net to limit opportunism when necessary.

§ 3.3 Business Judgment Rule

Under Delaware law, the *Business Judgment Rule* protects directors' decision-making, provided they act in good faith, with due care, and in the best interest of shareholders. Contracts cannot exempt them from these duties. Delaware law upholds a board's decisions as long as they are

informed and rational but doesn't allow fiduciary duties to be completely overridden by contractual obligations.

In the Netherlands the concept of fiduciary duties and the Business Judgment Rule is not used as such, but managing and supervisory directors do have a legal duty to focus on the company's interests and those of its affiliated enterprise in the performance of their duties. The interpretation of these interests depends on the specific circumstances of the case, as illustrated by the Dutch Supreme Court in the *Cancun* decision[9], which upheld management autonomy in closely-held companies.

This means that in the Netherlands the duty of good governance is broader than just fulfilling the fiduciary duties of care and loyalty; good governance also focuses on the interests of the company and its stakeholders. In the Netherlands, a director can only be held liable if he acts seriously culpable (high threshold). Thus, with respect to director liability, Dutch and Delaware law can lead to different outcomes.

§ 3.4 Corporate Opportunity

Another key difference is the "Corporate Opportunity" doctrine. In Delaware, investors can waive this doctrine by including a provision in the company's bylaws or through a board resolution. This waiver, known as a corporate opportunity waiver, can be applied conditionally. For Limited Liability Companies (LLCs), more flexible rules apply due to the contractual approach to this legal form under Delaware law.

However, under Dutch law, a director of a Dutch professional limited liability company cannot apply a general corporate opportunity waiver, as stipulated in Articles 2:8 and 2:9 of the Dutch Civil Code (DCC). In cases involving conflicts of interest, directors must ensure they act in the best interests of the company, while retaining the flexibility to make sound judgments. Although general corporate opportunity waivers are not possible in the Netherlands, Dutch corporate law still offers numerous opportunities for investors to establish their special contractual rights.

There is an important distinction between the two systems: in Delaware, all contractual remedies (within the limits of the law) are available to investors to redistribute financial and control rights efficiently. In the Netherlands, however, the principles of reasonableness and fairness (Articles 6:248 and 2:8 DCC) can always play a limiting role. Reasonableness and fairness may impose additional obligations depending on the nature of the agreement and the specific circumstances, potentially limiting the agreements between the parties. While Article 6:248 DCC requires courts to exercise restraint in applying these principles, the variability in cases may lead to legal uncertainty and costs for investors.

§ 3.5 Legal Formalities

As mentioned earlier, both Delaware and Dutch corporate law offer flexibility and contractual freedom to agree on specific rights and obligations within corporations. One notable difference is that in the Netherlands, certain legal actions, such as incorporating a company, issuing

shares, or making changes to the articles of association, must be notarized. This contrasts with the more flexible Delaware system.

---

4. Conclusion and Practical Strategies for U.S. Investors

In conclusion, Dutch corporate law plays a crucial role in minimizing agency and coordination problems between investors and business owners. Its structure promotes transparency, accountability and alignment of interests, which are essential for fostering investor confidence.

While some degree of uncertainty will always exist, it can be argued that, based on the principle of freedom of contract, the contractual rights of investors are generally enforceable under Dutch law. However, the ability of an investor to use the company as leverage for their own benefit is significantly limited by the principle of management autonomy. Additionally, in certain circumstances, even investors must take into account the corporate interest in their decision-making. The special contractual rights that investors seek to negotiate require a high degree of contractual freedom. Although both Delaware and Dutch law offer this freedom, Dutch freedom of contract is subject to the principles of reasonableness and fairness, which may restrict the exercise of such rights.

To mitigate the risk of opportunism by management and enhance value for investors, U.S. investors should consider the following strategies:

1. **Leverage Legal Provisions:** The Dutch Civil Code allows for the inclusion of a statutory right of instruction, which requires the board to follow directives from another corporate body, such as the general meeting of shareholders or the meeting of holders of shares in a particular class or designation. These instructions can be ignored only if they conflict with the interests of the company and its affiliated enterprise. So make use of the Dutch Civil Code to include specific rights of instruction, requiring the board to follow directives from shareholders or a designated group of stakeholders. Custom-made agreements in shareholders' agreements and tailored provisions in bylaws can be effective tools for leveraging investors' rights to vote and influence key decisions, helping align interests and clarify expectations.
2. **Monitor Governance Structures:** Stay actively involved in both the management and supervisory boards to keep a close eye on the company's operations. Engaging with supervisory board members can provide valuable insights into management practices and the company's overall strategy.
3. **Push for Clear Policies:** Investors can promote clear policies regarding stakeholder engagement and corporate responsibility. By encouraging transparency and accountability, investors can ensure that strategic decisions align with their interests.
4. **Collaborate with other investors:** Form alliances with fellow investors to increase bargaining power and streamline decision-making processes.

By adopting these strategies, U.S. investors can effectively navigate the complexities of Dutch corporate law, minimize risks and enhance value. With the right legal support, your investment in a Dutch company can lead to sustainable, long-term growth.

Notes:
[1] For the comparison between U.S. rules, standards and default privisions and the Dutch equivalent thereof and differences I chose Delaware law.
[2] A full-ratchet clause grants the owners of preferred shares the right to convert at the lowest available price. A weigthed-average clause adjust the conversion price of convertible securities based on a weighted average formula that takes into account both the old and new shares and their respective prices. The adjustment ensures that the conversion price is lowered but not to the extent of the new issuance price.
[3] Broad-based weighted averages include a wider range of stock when calculating a conversion price. This includes all fully diluted and outstanding common stock. A narrow-based weighted average doesn't include fully diluted share capital in its calculations. Therefore, for instance, employee share options would be included in a broad-based weighted average but excluded from a narrow-based calculation. Generally speaking, the narrow-based formula works in favour of the holders of preferred stock (i.e., investors) and usually dilutes existing common stockholders to a greater extent.
[4] A right of existing shareholders in a corporation to purchase newly issued stock before it is offered to others in order to maintain their proportionate ownership in the company, even if new shares are issued.
[5] McRitchie v. Zuckerberg, C.A. No. 2022-0890-JTL (Del. Ch. 2024):
https://courts.delaware.gov/Opinions/Download.aspx?id=363410
[6] McRitchie v. Zuckerberg, C.A. No. 2022-0890-JTL (Del. Ch. 2024):
https://courts.delaware.gov/Opinions/Download.aspx?id=363410
[7] HR 13 juli 2007, NJ 2007/434 (ABN Amro), r.o. 4.5 and HR 9 juli 2010, NJ 2010/544 (ASMI), r.o. 4.4.1
[8] HR 4 april 2014, ECLI:NL:HR:2014:797, NJ 2014/286; RO 2014/43; JOR 2014/290 (Cancun).
[9] HR 4 april 2014, ECLI:NL:HR:2014:797, NJ 2014/286; RO 2014/43; JOR 2014/290 (Cancun).

If you're considering investing or setting up business in the Netherlands, our expertise can help you navigate the complexities of Dutch law while maximizing your investment potential. Contact us at Loor Legal & Partners for a consultation and customized legal strategy.

About Loor Legal & Partners

Loor Legal & Partners is a boutique law firm based in the Netherlands, specializing in commercial and corporate law. We do not just provide legal assistance, but help our clients realize their vision. Our strength is our fast response, personalized service and focus on client success. With a proven track record in business acquisitions, participations and mergers, we are proud of the reputation we've built.

Why Engage Loor Legal & Partners?

- Expertise in M&A support for small and medium enterprises.
- Flexible and specialized knowledge with short lines of communication.
- Dedicated partners throughout the entire process.
- Experienced in advising and conducting legal proceedings, particularly in corporate law.

Ernest Loor, attorney-at-law
Email: loor@loorlegal.nl
Tel: +31 (0)55 303 19 50
Mob: +31 (0)6 54 361 438