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From Autonomy of Interests to Concurrence of Interests in Dutch Group Company Law

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Introduction

As is the case in almost every European country, company law in the Netherlands is based on the theory that every individual legal entity – in the Netherlands usually NVs and BVs – has an independent economic interest which serves as the primary and decisive guideline for the actions of the board of management. The rule applies for companies that operate as a separate commercial entity but also for operating companies and holding companies that form part of a larger group. The interests of the individual group company do not always correspond with, or are not *per se* parallel to, the interests of the group as a whole. In this article I refer to this basic premise in short as *the principle of autonomy of interests*.

This principle impacts on various legal issues pertaining to the relationship between a parent company and its subsidiary. In the first place, it affects the question of whether there is a hierarchical relationship between these two group companies. Can the parent company issue instructions which the directors of the subsidiary are obliged to follow? Does the parent company have the right to issue instructions concerning matters that are typically the responsibility of the management, such as the dismissal of employees, investments and public relations? Under existing Dutch company law it is generally assumed that it does not.¹

The principle of autonomy of interests also has an impact on the application of the doctrine of *ultra vires*. The company's objects as defined in its articles of association determine in part the scope of the activities within which directors can represent the company. Under Dutch law, under certain circumstances *ultra vires* can be successfully invoked by the company against

third parties (Article 2:7 of the Netherlands Civil Code (NCC) in conjunction with Article 9 (1) of the 1st EC Company Law Directive). The company is then not bound by the relevant juridical act. However, under Dutch law the company's objects must also be interpreted in light of the interests of the company and its associated business.² There are even authors who defend the position that a juridical act that manifestly conflicts with the interests of the company is *ultra vires* even if that juridical act is specified *verbatim* in the objects in the articles of association.³ In other words, according to this view, on which the Supreme Court has not in fact ever expressed an opinion, even a broad definition of the company's objects does not help. According to this view, under extreme circumstances the principle of autonomy of interests derogates from the *verbatim* text of the company's objects. This might be the case, for instance, if security is provided for the debt of a group company in the context of group financing at a time when that security is soon expected to be called in, with the likely consequence that the company from whom the security is recovered will become bankrupt. It is not surprising that although *ultra vires* is seldom successfully invoked in case law it is an instrument that still always forces Dutch lawyers to observe extreme caution and to formulate extensive caveats when rendering a legal opinion. Of course there would be less need for such cautiousness if as a rule the interests of the individual subsidiary would be deemed to run concurrently with the group's interests.

Finally, the principle of autonomy of interests plays an important role in the application and scope of the doctrine of conflict of interest. By contrast with most other European countries, the rules on conflict of interest in the Netherlands, as set out in Article 2:256 NCC⁴ are part of the doctrine of representation of

1 For an extensive discussion of this point, with reference to relevant case law and literature, see Bartman/Dorresteyn, *Van het concern*, Kluwer-Deventer, 6th ed., 2006, Chapter IV, pp. 81-98.

2 Supreme Court, 20 September 1996, NJ 1997, 149 (*Playland*).

3 Van Schilfgaarde/Winter, *Van the BV en the NV*, Kluwer-Deventer, 14th ed., 2006, p. 176. Also on this point, Th.A.L. Kliebisch, (Sombere) overpeinzingen bij het haardvuur, in the collection *10 jaar JOR, alsnog geannoteerd*, Sdu-The Hague, pp. 149-155 and C.J. Jager, *Doeloverschrijding en concernfinanciering, Vermogensrechtelijke annotaties 2007/1*, pp. 5-21.

4 In this article I refer only to the legal provisions relating to Dutch private companies and not to the generally identical provisions for public companies.

a legal person. If that legal provision applies, the company was not duly represented and is therefore in principle not bound by the relevant juridical act. As in the case of *ultra vires*, if conflict of interest is successfully invoked it can have an effect on third parties, which is what makes it such a dangerous legal instrument. The result could be, for example, that a mortgage issued by a subsidiary as security for a debt of its parent is null and void if the subsidiary was represented by the parent in its capacity as director of the subsidiary when the security was provided. As a consequence here too we see that in practice lawyers are – and should be – extremely cautious when giving an opinion on conflict of interest in relation to a Dutch company.

In a sense the authority to issue instructions, *ultra vires* and conflict of interest are ‘Siamese triplets’ bound together by the ‘umbilical cord’ of the traditional principle of autonomy of interests, which also applies for the individual subsidiary.⁵ Recent developments in Dutch company law seem to reveal a shift in this situation however. These changes have been initiated by the legislature but also spring from the case law of the Supreme Court. It is a shift from the principle of autonomy of interests to *the principle of concurrence of interests* as the basic guideline for deciding on disputes between companies within a group. The effects of this important shift will be felt mainly in the area of advocacy. I will now explain these changes and their consequences.

Power to issue instructions

As already mentioned, up to now it has been assumed that a parent company does not have the power to issue binding instructions to its subsidiary, on the grounds of its shareholding or otherwise, on matters that are typically reserved to the directors.⁶ The law only allows for a clause to be inserted in the subsidiary’s articles of association giving the parent company power to instruct it on *general lines of the policy to be pursued* (Article 2: 239 (4) NCC), but no one knows precisely what that means and how these general lines should be distinct from concrete and detailed instructions in the field of day to day management. However, this situation is likely to change shortly following intervention by the legislature. The above quoted clause will be amended by the impending legislation designed to simplify the legal rules governing private companies and make them more flexible and will then read as follows:

The articles of association may provide that the directors must

*behave in accordance with the instructions of another body of the company. The directors are obliged to follow the instructions unless they are in conflict with the interests of the company and of its business.*⁷

In the Explanatory Memorandum the notes to this clause state that if such a provision is included in the articles of association the directors of the subsidiary must not slavishly follow the instructions of the parent company and must continue to assess those instructions in light of the interests of the subsidiary. Nevertheless, this provision does mark a significant swing in the relationship between the parent company and its subsidiary, especially in the Netherlands where the legal form of a subsidiary tends to be that of a private company. After all, it is clear that if such a provision is included in the subsidiary’s articles of association the directors are as a rule legally obliged to follow the instructions of central group management. That turns the existing situation upside down, since the primary consideration of the subsidiary’s directors in the weighing up of interests is no longer the interests of the subsidiary but rather those of the group as a whole, as formulated and laid out by the group management. The interests of the subsidiary now serve as just a *correction factor* for extreme situations in which compliance with the group management’s instructions is likely and manifestly to threaten the sub’s identity or even continuity. Another way of putting it is that, according to the – albeit optional – provisions of the bill, the interests of the subsidiary are in theory assumed to be concurrent with the group’s interests, as defined by the group management, unless the directors of the subsidiary argue and prove the contrary in the specific case. Or to put it yet another way, the traditional principle of autonomy of interests is replaced – or at least *may* be replaced in the articles of association of the subsidiary when the bill becomes law – by the principle of concurrence of interests.

As already mentioned, this change in the point of departure will impact mainly on the obligation to furnish evidence and the allocation of the burden of proof in disputes between a parent company and its subsidiary.⁸ After all, whereas in the current situation the group management will have to argue and, when disputed, demonstrate in such case that the group interest is specifically and disproportionately prejudiced by failure to follow the instructions, if the clause stipulated in the bill is included in the subsidiary’s articles of association it will be the directors of the subsidiary that have to argue and prove that carrying out the instruction will specifically and disproportionately prejudice

5 Although I realize that this metaphor reflects only a poor understanding of the physiognomy of triplets, it suits my purposes well.

6 In practice disputes between a parent company and its subsidiary generally resolve themselves since the parent as majority shareholder of the subsidiary can always dismiss the recalcitrant board of the subsidiary and replace it with another at the general meeting of shareholders, or threaten to do so (Article 2:244 NCC).

7 Private Company Law (Simplification and Flexibilization) Bill, Parliamentary Documents 31058.

8 There is in fact still the possibility that in the specific case the court will reverse the burden of proof on the grounds of reasonableness and fairness pursuant to the provisions of Article 150 of the Netherlands Code of Civil Procedure. On the importance of the allocation of the burden of proof in intra-group legal disputes, see B. Wachter, *Concernrecht en bewijs(mogelijkheden)*, in *Van Vennootschappelijk Belang, liber amicorum Prof. Mr. J.J.M. Maeijer*, W.E.J. Tjeenk Willink-Zwolle, 1988, pp. 379-391.

the interests of the subsidiary. This is an important, and possibly decisive, distinction, from a procedural perspective.

Conflict of interest

Conflict of interest has probably been the most controversial topic in Dutch company law in recent years. For a brief review of the current status of legislation and case law I refer to my Country Status Report in *European Company Law* in February of last year.⁹ In that survey I formulated a number of questions concerning the interpretation of the relevant legal provision (Article 2:256 NCC) which urgently needed to be answered for the sake of legal certainty in commerce. The Supreme Court recently answered two of these questions in its *Bruil* judgment.¹⁰ The questions were:

1. What if there is no pecuniary personal interest of the director involved but merely a situation in which he also acts as director – executive or non executive – or as a member of the supervisory board of the contracting party, e.g. the bank that grants a credit facility to the company? Does this purely functional conflict of interest also fall within the scope of Article 2:256 NCC?
2. If the mere possession of (the majority of) all shares in combination with directorship in the same companies already creates a conflict of interest as meant in Article 2:256 NCC, should there not be an exception for group company relations?

In the *Bruil* judgment, the Supreme Court answered the first question in the negative. A strictly functional conflict of interest (in Dutch: *kwalitatief tegenstrijdig belang*) does not – at least not automatically – fall within the scope of Article 2:256 NCC. In the view of the Supreme Court there must always be an actual situation in which the director ‘*due to the existence of a personal interest or through his involvement with another interest that is not concurrent with that of the legal entity, must be deemed incapable of safeguarding the interests of the company and its business in a manner that may be expected of a trustworthy and unprejudiced director*’.¹¹

The Supreme Court gave a cautiously positive answer to the second question. The relevant grounds of the judgment lead to the conclusion that the group’s interest must in any case not be regarded as ‘*an interest that is not concurrent with that of the legal entity*’ as referred to above. In fact, in my view the Supreme Court generally assumes that the interests of the parent and the subsidiary are parallel for the purposes of the application of Article 2:256 NCC. This is apparent from the following ground of the judgment (no. 3.6):

‘Particularly in those cases where a natural person is acting in the capacity of director and shareholder of different companies that constitute a group there will not readily be a conflict of interest within the meaning of Article 2:256, precisely because the intention of retaining (ultimate) control in the hands of one person is to ensure that the weighing up of the interests of all those group companies is concentrated in that person. After all, the interests of the company and its business and the interests of the relevant director and shareholder are then so closely related that there will only be a conflict of interest in exceptional circumstances.’

Although the Supreme Court formulates the principle of concurrence of interests with respect to a director who is a natural person, it is impossible to see why the same consideration would not apply in the situation where a legal entity acts as director of two or more other group companies. Briefly, the holding company/director will in principle also be deemed to be representing an interest that is concurrent with that of its subsidiaries. In other words, only if the directors of the subsidiary – or the administrator in the event of the company’s bankruptcy – demonstrate in legal proceedings that this was not in fact the case at the time of the disputed juridical act, the legal assumption of concurrence of interests must then yield to the proof of a conflict of interest. In this case it is not the legislature but the Supreme Court that has imposed the burden of proof on the directors of the subsidiary if they invoke a conflict of interest in the relations within a group. However, here we see a similar shift away from autonomy of interests to concurrence of interests. This will necessarily translate into a change in the position of the parent and its subsidiary during legal proceedings with respect to the duty to furnish facts and the burden of proof.

Ultra vires

I have already referred to the close relationship that exists between the theories of *ultra vires* and conflict of interest. This relationship is due to the fact that under Dutch law the company’s objects must be interpreted in light of its interests. Judgments of the Supreme Court on conflict of interest, such as the *Bruil* decision, are therefore also relevant for the subject of *ultra vires* and the interpretation of Article 2:7 NCC, at least to the extent that the Supreme Court pronounced findings and decisions on aspects that are common to both doctrines in those cases. Their application is then at least likely to be the same.¹²

Having said that, the Supreme Court’s finding that signified a shift from autonomy of interests to concurrence of interests

9 ECL, Volume 3, Issue 1, Report from the Netherlands, pp. 33-34

10 Supreme Court, 29 June 2007, JOR 2007/169 (*Bruil*). See my Country Status Report in ECL 2006/1 for the case stated and the contested judgment of the Appeal Court.

11 Ground 3.4

12 Cf. E.J.P. van den Ingh, *Concernkrediet en solidariteit, Ondernemingsrecht* 2005-9, pp. 318-319, footnote 8.

referred to above was a finding of a general nature and as such applies in full to disputes between a parent and its subsidiary where *ultra vires* is invoked. Such an appeal to *ultra vires* will generally be made by the administrator in the bankruptcy of a subsidiary to prevent the lending bank from recovering the securities that were provided.¹³ The shift in the basic principle described above will also lead in such cases to a change in the allocation of the obligation to furnish facts and the burden of proof between the parties to the proceedings, subject to the decision of the judge to allocate the burden of proof differently on the grounds of reasonableness and fairness pursuant to Article 150 of the Code of Civil Procedure. Once it is established that the parties to the proceedings are in a relationship of dependency within a group, as referred to by the Supreme Court in the *Bruil* judgment, it is in principle up to the subsidiary to argue and to prove that its interest – and hence its object within the meaning of Article 2:7 NCC – was prejudiced by the disputed juridical act in the specific case and that the legal assumption of concurrence of interests must yield to that established fact.

Conclusion

This article is concerned with what is sometimes known as ‘intra-group company law’. In other words, the law governing the legal relationships between legal entities and their bodies, which together constitute the economic and organizational entity that is the group. The power of a parent company to issue instructions, the circumstances under which actions of the subsidiary are *ultra vires* and the existence of a conflict of interest between the parent and subsidiary are issues that play a key role in intra-group company law. These issues have traditionally been addressed on the basis of the principle of autonomy of interests, in other words the assumption that each subsidiary has an independent economic interest that serves as the principal and decisive guideline for the actions of its directors. In the Netherlands we have recently observed a shift in this policy, in the sense that in the case law of the Supreme Court the principle of autonomy of interests is gradually being replaced by the principle of concurrence of interests. This year’s *Bruil* judgment illustrates this development. This change in guiding principle leads to a reversal of the burden of proof in disputes between a parent and its subsidiary. But also the possibility of inserting a provision in the articles of association of a subsidiary specifically allowing the parent company to issue instructions, provided for in the pending law to simplify the law on private companies and to make it more flexible, is a contributing factor. This trend is bringing company law in the Netherlands more closely into line with the economic reality of relations within a group, which is a good thing.

13 Cf. R.J. Abendroth, *Herfinanciering van noodlijdende ondernemingen*, in the collection *De financiering van de onderneming*, published as Part 88 in the book series of the Van der Heijden Instituut, Kluwer-Deventer, 2006, pp. 51-65.