COMPANY & COMMERCIAL - NETHERLANDS

Distributions of profits to shareholders under corporate law

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Introduction

For most companies, December 31 is also the end of the financial year, although – depending on the nature of a company's needs – this may differ. After a company's financial year ends, the board must draw up the annual financial statements, which must subsequently be adopted by the general shareholders' meeting (GSM).

The GSM is empowered to allocate the profits which have been determined through the adoption of financial statements and distributions. In most countries, the distribution of profits to shareholders must initially satisfy balance sheet and economic tests.

However, under Article 2:216 of the Civil Code, no balance sheet test is required in the absence of reserves that must be maintained by law or pursuant to a company's articles of association. This means that distributions in the event of or resulting in a negative equity are possible, even if there is no profit in the relevant financial year. Where there are statutory reserves or reserves provided for by a company's articles of association, a limited balance sheet test must be undertaken.(1)

Resolution of GSM and board of directors

Article 2:216, Paragraph 1 of the Civil Code stipulates that a GSM is empowered to allocate the profits which have been determined through the adoption of financial statements and distributions, to the extent that the company's equity exceeds the reserves which must be maintained by virtue of the law or its articles of association. These powers may be limited or assigned to another corporate body by the articles of association (eg, the articles may provide that the board of directors or the supervisory board has these powers).

The board of directors fulfils a prominent role in allocating distributions to shareholders, as shareholders cannot withdraw capital from the company without the board's intervention. Under Article 2:216, Paragraph 2 of the Civil Code, a GSM resolution concerning a distribution has no effect if the board of directors has not given its approval therefor through a resolution. The board of directors will refuse such an approval only if it is aware or should reasonably foresee that after such distribution, the company will be unable to continue to pay its due and payable debts (ie, the economic test).

Economic test

The economic test might lead to uncertainty regarding the permissibility of a distribution, as it is not

based on a company's financial statements. Rather, it requires a reasonable opinion of whether the company can continue to fulfil its due and payable obligations in future (eg, the Gelderland court's decision in *Walas v PMR*). This analysis should examine, among other things, the company's:

- liquidity;
- anticipated solvency;
- profit margins; and
- sales.

Creditor protection

A company's creditors derive a certain level of protection from the outcome of an economic test, as:

- the members of its board of directors can be held personally liable if the analysis is not undertaken or is undertaken inadequately; and
- the creditors can claim and recover the amount wrongfully paid from the shareholders.

Board of directors' liability

If a company cannot continue to pay its due and payable debts after a distribution, the members of the board of directors (or persons who determined or cooperated on company policy as if they were directors) will be jointly and severally liable to compensate the company for any shortfall which results from the distribution where they were aware or should reasonably have foreseen this at the time of the distribution.

In *Walas*, the court ruled that since the company was still in its start-up phase, the board of directors should have acknowledged that it did not have full insight into the company's financial situation. The court thus concluded that the economic test had been carried out inadequately and held the members of the board of directors personally liable for the shortfall which had resulted from the distribution.

Individual members of a board of directors can exculpate themselves by proving that:

- the company's distribution of profits was not attributable to him or her; and
- he or she was not negligent in taking measure to avert its consequences (eg, in practice, this will apply to board members who were dissatisfied by an economic test and voted against approving a distribution).

Shareholders' liability

Shareholders who received a distribution even though they knew or should have foreseen that the company would subsequently be unable to continue to pay its due and payable obligations can be sued by the company's bankruptcy trustee to make up for the deficit that occurred as a result of the distribution, up to no more than the amount or value of the distribution received by the shareholder.

Comment

A Dutch private limited company can make distributions of profits to its shareholders if the company's capital exceeds the aggregate of the reserves that must be maintained pursuant to the law and the company's articles of association.

A distribution first requires the passing of a resolution by a corporate body authorised to do so pursuant to the articles of association (usually the GSM). Second, the decision to distribute profits requires the board of directors' approval. The board can refuse such an approval only if it is aware or reasonably foresees that after such distribution, the company will be unable to continue to pay its due and payable debts.

In the event that a company cannot continue to pay its due and payable debts after a distribution, the members of the board of directors can be held liable to compensate the company for any shortfall which results from the distribution and the company's bankruptcy trustee can claim and

recover the amount wrongfully paid from each shareholder.

For further information on this topic please contact Mike van de Graaf at AKD by telephone (+31 88 253 50 00) or email (mvandegraaf@akd.nl). The AKD website can be accessed at www.akd.nl.

Endnotes

(1) This update examines the legal framework of Article 2:216 of the Civil Code, which applies to private limited companies incorporated under Dutch law. It does not discuss the legal framework of Article 2:105 DCC – based on EU Directive 2012/30/EU – which applies exclusively to Dutch public limited companies.
