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Trend Report

Board observers in Dutch companies



Board observers in the Netherlands >

Board observer use cases >

Considerations for the use of board observers in Dutch companies >

Expectations for the future >

Your Loyens & Loeff contacts >

Trend report – Board observers in Dutch companies

Investors commonly seek board representation to monitor the companies in which they participate. We are seeing an increase in the use of so-called ‘board observers’ in Dutch companies, *i.e.*, investor representatives that take on a monitoring or advisory role at board level without being formally appointed as a director or officer of the company. In this trend report, we share our views on the use of board observers in the Netherlands and expected developments.

Board observers in the Netherlands

Dutch companies are free to structure their governance to suit their specific needs within the constraints of applicable law and constitutional documents. Absent a statutory basis for board observers, parties have significant freedom in determining the role and position of board observers on boards of Dutch companies. Dutch doctrine on board observers has not (yet) seen significant development and, consequently, limited guidance is available. In our experience, parties tend to take inspiration from the more developed US or UK precedent when installing a board observer in Dutch companies.

The use of board observers in Dutch companies does not require a basis in constitutional documents. Rather, they will typically be installed pursuant to a contractual agreement to that effect between the company and a third party (*e.g.*, an investor). Such contractual agreement would then set out the role and involvement of the board observer, including appointment and dismissal mechanics. Board observers tend to be given (a) an observational role, allowing their principal to monitor the board more closely, and/or (b) an advisory role, ensuring that their principal’s interests are duly observed in the board process.

Dutch law allows board observers to attend and participate in board meetings. Depending on what is agreed upon, the board observer may take a purely observational role, but may also take a more advisory role during such meetings. Board observers may also be copied in on internal correspondence within the company. Dutch law does not provide for a concept of board privilege or

confidentiality. As such, the board observer is in principle free to share information with the party having appointed that observer. In sharing such information, the board observer will, however, need to observe any applicable market abuse regulations and any (other) statutory or contractual limitations.

During board meetings, board observers may provide their input and advice. Whereas managing and supervisory directors of Dutch companies are held to observe all of the company’s stakeholders’ interests, board observers may in principle act solely in the best interest of the party having appointed that board observer. Statutory conflict of interest rules and fiduciary duties, strictly speaking, do not apply to board observers, providing for more significant discretion. While this may allow for extensive involvement of the board observer, that board observer should take care to avoid qualifying as a shadow director, as this would lead to the board observer being subject to the same responsibilities and liability regime as the formal directors. At the same time, while directors may consider advice and input provided by board observers, they should be mindful of the partial position of such board observers.

Accordingly, board observers may grant investors a relatively informal way to monitor their portfolio companies and ensure that their interests are duly addressed. This may also be an attractive instrument for companies, given that board observers, typically, will not have formal control rights and, therefore, have limited direct control over the company and its business. This means that the appointment of a board observer may constitute a less intrusive alternative to granting a board seat.

Board observer use cases

Board observers can be used in a wide array of cases, ranging from purely observational roles in order to decrease information asymmetry between the company and an investor to a closely-involved trusted advisor who may be called upon by the board if needed. For illustrative purposes, we have set out three such use cases below:

- a. **Investment monitoring.** By observing board meetings, the board observer will likely obtain information that investors, typically, would not obtain otherwise. This may also be a more efficient way to obtain information than (contractual) shareholder visitation or inspection rights. Accordingly, board observers may play an important role in allowing investors to monitor their portfolio companies.
- b. **Indirect board representation.** Board observers may provide advice and give views that can be considered during board deliberation. The board observer may thus help ensure that its principal's interests are duly observed, without requiring direct board representation.
- c. **Board mentor.** Experienced investors may also use board observers to supplement inexperienced boards. Experienced venture capitalists may thus install board observers to mentor young and promising start-ups, helping to professionalise their business and practices.

Considerations for the use of board observers in Dutch companies

Given the significant freedom Dutch company law offers, and absent clear case law or scholarly doctrine, there is no established standard for board observers in Dutch companies. When opting to use board observers, parties should in any case consider the following:

- i. **Clear agreements.** Parties should take care to draft clear provisions regulating the position of the board observer. This may help prevent disputes and uncertainty on crucial matters concerning the board observer, including its involvement in

board matters and appointment and replacement mechanics. These provisions can be laid down in a contract, such as a shareholders' agreement, or the articles of association, possibly supplemented by board regulations.

- ii. **Scope of involvement.** Given the lack of statutory governance provisions, attention should be given to the scope of the board observer's involvement. For instance, parties should consider (a) whether the board observer may attend all board meetings, or only those relating to certain reserved matters; (b) if any measures should be taken to address (potential) conflicts of interest rules between the company on the one hand and the board observer or its principal on the other; (c) under what circumstances the board meets / can meet without the board observer being present; and (d) how and in what way the board observer may provide input on the board process (if at all).
- iii. **Confidentiality.** Given that the board observer may obtain significant and potentially sensitive information on the company that would otherwise not be available to an investor, the company should consider including clear and enforceable confidentiality provisions in the relevant contractual framework.

Expectations for the future

We expect to see a further increase in the use of board observers in the Netherlands, especially by private equity and venture capital investors. The more well-established these board observers become, the more likely this is to impact Dutch corporate governance standards. This may help develop a more established market practice and doctrine on the role and composition of board observers for Dutch companies.

Your Loyens & Loeff contacts

For more information, please reach out to Mijke Sinnighe Damsté, Bastiaan Cornelisse, Michel van Agt, Bastiaan Kemp or Philippe Hezer.



Mijke Sinnighe Damsté

Partner / Attorney at law

T +31 20 578 56 66

E mijke.sinninghe.damste@loyensloeff.com



Bastiaan Cornelisse

Partner / Civil law notary

T +31 10 224 65 28

E bastiaan.cornelisse@loyensloeff.com



Michel van Agt

Partner / Senior deputy civil law notary

T +31 20 578 52 61

E michel.van.agt@loyensloeff.com



Bastiaan Kemp

Attorney at law

T +31 20 578 50 46

E bastiaan.kemp@loyensloeff.com



Philippe Hezer

Attorney at law

T +31 20 578 59 26

E philippe.hezer@loyensloeff.com



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