Observers at the Table – Role and Risks

Private equity (PE) and venture capital (VC) often seek the right to appoint a board observer for a new portfolio company. This can happen for various reasons. For instance, a firm may have invested too little to secure a board seat or may have initially held a significant stake during seed financing but later saw its ownership diluted in subsequent rounds, losing the right to appoint a director. Furthermore, PE and VC players might be reluctant to try and obtain a board seat because of the possible risks/liabilities associated with directorship.

In this Strelia Corporate Series, we address the status of these board observers.

In the Room, But What's Their Role?

Belgian company law, i.e., the Code of Companies and Associations (**BCCA**), does not have rules governing board observers. Investors and shareholders can therefore freely determine the role and position of board observers whom they appoint to attend board meetings of Belgian companies.

Their role will therefore often be outlined in the shareholder- or investment agreement. This role can be limited to a mere right to obtain information or to be invited to board meetings and listen. And the agreement can also grant broader rights of involvement that entails a consultative vote or the right to convene board meetings.

Since board observers are not appointed by the general assembly but rather by the parties to the shareholder- or investment agreement, they will in principle not owe any duty to the company, such as the duty of discretion that directors owe. Because of this, it is important to have a shareholder- or investment agreement set out the rights and obligations of board observers and to make sure that the appointed observer will adhere to the rules agreed upon between parties. Furthermore, the parties to those types of agreements should consider having the board observer sign an NDA with the company as well.

Crossing the Line

Observers should be careful not to encroach on director's prerogatives and not be too involved in the company's management to avoid the risk of being considered *de facto* directors.

The BCCA does not use the term '*de facto*' or 'shadow' director but refers to '*persons who hold or have held the power to effectively manage the company*'. Regarding the latter expression, this would be so if the persons who were not formally appointed as directors by the general meeting would perform *acts of management or governance in complete independence,* without having been formally entrusted with or authorized to perform such task by the company. Pursuant to the BCCA and the Belgian Code of Economic Law, these persons would be held liable as if they were directors.

This also gives rise to the question whether the liability caps applicable to directors under the BCCA would also apply to board observers. As a matter of fact, a director's liability for mismanagement or wrongful trading is capped between EUR 125,000 and EUR 12 million, depending on the size of the company. Although scholars debate this in legal doctrine, a clear majority believes that no liability cap should apply to board observers. Board observers therefore risk an uncapped liability if they are considered *de facto* directors. Moreover, D&O insurance typically does not cover the liability of *de facto* directors, which means any wrongdoing by board observers (who are considered *de facto* directors) would not be covered.

Considering the above, board observers should ensure that any statements they make or positions they take at board meetings are merely suggestions and that they do not intend to steer the company. Furthermore, parties should have shareholder- or investment agreements describe the board observer's role clearly and consider subscribing to a broad D&O policy that also covers liability of persons that may be considered *de facto* directors.

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