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D&O-insurance: expectations and reality often diverge

1. INTRODUCTION

The directors & officers-insurance (D&O) has become established as part of the insurance program of German companies. Companies insure themselves against managers' mistakes which might lead to a financial loss for the company. The managers themselves are insured by the D&O-insurance against claims of the company or third parties following wrong decisions.

Strict laws and jurisdiction make D&O-insurances necessary. To justify the claim of a company it is already sufficient that the manager's conduct within his duties leads to a damage. The manager must exonerate himself. If he does not succeed in doing so, he is liable for the damage. Already in 1997, the Federal Court of Justice ("BGH") decided for stock corporations that even the supervisory board is liable for a damage if it did not claim against the executive board though it would have made economic sense. The stock corporation must thus claim against the executive board if such claims arose.

A D&O-insurance can therefore help to secure risks in case of damage.

2. EXPECTATIONS

In practice, it often becomes evident that the handling of the D&O-insurance in case of conclusion and claim settlement is often subject to misunderstandings due to wrong expectations: The company is the policy holder. The ordinary person hereof educes that the company is the owner of the coverage claim against the insurer. This is wrong, because the manager is the insured person. Members of management though often assume that they are comprehensively insured by an existing D&O-insurance and therefore don't need to care for the claim settlement. If the manager is then nevertheless affected by a claim, he assumes that the insurer also pays for all attorney fees. These assumptions lead to disruptions.

The insurer for his part wishes to avoid the payment for the damage since the amount of the damage usually exceeds the premium of the individual contract by far. He therefore tries hard to exclude risks with a high occurrence probability already with the conclusion of the contract. Furthermore, the insurers often assume that a D&O-dispute should come along with the manager's loss of his employment contract. A dispute between the company and the manager allows the insurer to defend

the manager with strong effort against the claims. The insurer must not pay attention to an existing employment since the manager's sole interest is in his defense and a further constructive performance in the company plays no role. The companies though wish to realize continuity in management with the D&O-insurance and wish to continue the productive work with their executives.

3. FUNCTIONALITY OF CLAIMS FOR COVER

In fact, it is rather like this: The D&O-insurance provides the manager with two major entitlements. On the one hand, the D&O-insurance covers the costs of the defense against the claim. On the other hand, the insurer provides a claim for indemnification from liability claims of third parties (also of the company). The functionality of the D&O-insurance thus requires the manager's claim. The company has no direct entitlement towards the insurer.

In 2008, the legislator created the possibility that the coverage claim in the liability insurance might be ceded to the injured party. In the D&O-insurance this would imply that the company could act directly against the insurer after the manager has ceded his cover claim to the company. From the insurer's point of view, there is then the risk that the company cooperates with the manager in order to receive the cover amount. The legislator though assumes an honest policy holder. Besides, the law offers many possibilities to work against fraudulent conduct. It should therefore be paid attention not to include ambiguous regulations into the contract.

The expenses for the defense against the company's claims imply a severe damage risk for the insurer. Attorney costs for the defense against claims are therefore often not covered to the full amount. Costs for the assertion of the cover claim against the insurer are not covered by the contract at all. By now, the market though offers legal expenses insurances which cover the costs for the assertion of the insurance claim.

4. ASPECTS OF THE CLAIM SETTLEMENT

Consequently, the claim settlement inherits problems not only due to the high loss amounts and its complexity. The manager is also emotionally confronted with the reproach of guilt. The D&O-insured event requires that the manager takes responsibility for a mistake. This idea needs getting used to by many managing personalities and is often incompatible with their self-perception. The high number of involved parties makes it difficult to evaluate the situation. Thus, each of them has the possibility to share the guilt (respectively the liability) among several persons. In judicial disputes this might lead to an action against management colleagues. Furthermore, the settlement is often disturbed by the expectation that the insurer will pay anyway and promptly. In fact, the settlement of D&O-insured events takes years.

The fine print offers surprises. Insurance law is a complex matter and is even more difficult in the field of D&O-insurance due to the fact that several parties are involved. Thus, already the knowledge of some instructions and regulations can harm if the manager violates them (so-called conscious violation of an obligation).

Finally, it is therefore recommended to avoid possible problems concerning the claim settlement by intensive examination and with the aid of a conceptual planning before the conclusion of the contract.

5. CONCLUSION

The D&O-insurance is necessary to provide managers with free hands and to allow for security for companies. The expectations on the D&O-insurance should be clear in advance. Offers have to be examined before the conclusion of the contract. In the insured event there is no automatic fully comprehensive insurance cover.

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