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RECHTSANWÄLTE

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D&O insurance for authorized representatives

Does liability follow coverage?

German labor courts increasingly focus on the question as to what D&O-insurance could influence the extent of liability of authorized representatives.

According to the jurisdiction of the Federal Labor Court (BAG), seeking D&O insurance cover by a company might effect that the authorized representative becomes fully liable rather than being liable just to a limited extent (i.e. usually limited to a three months' salary in case of gross negligence).

1. BACKGROUND

1.1 Limited liability in case of voluntary liability insurance

The BAG decided that a personal or professional liability insurance entered into on a voluntary basis by the employee has no effect on the internal risk sharing and the employee's scope of liability (cp. BAG NZA 1998, 310, 311).

1.2 Unlimited liability in case of compulsory liability insurance

In contrast, it is handed down by the court that an employee is fully liable in case the damage is covered by a compulsory liability insurance (e.g. motor vehicle liability insurance, compulsory labor liability insurance) (cp. BAG NZA 1998, 310, 311). The principle of limited liability for employees does not apply in such cases. The existence of the compulsory liability insurance ensures that the employee is not financially overstrained.

1.3 Unlimited liability in case of comparable liability insurance

In a decision of 28 October 2010 (cp. BAG 8 AZR 418/09, NJW 2011, 1096), the BAG held by *obiter dictum* that a voluntary liability insurance (e.g. a D&O-insurance) may have the same effect as a compulsory liability insurance. This could be the case if the

employer requests from the employee to seek liability insurance cover – in order to cover the risk of the work to be performed – as a compulsory requirement in the employment contract (and possibly pays additional salary for this).

2. UNLIMITED LIABILITY BY MEANS OF D&O INSURANCE?

According to the decision of the BAG, an authorized representative could be considered fully liable in two constellations:

First, the authorized representative could be considered fully liable if the employer agrees with the employee upon the conclusion of a D&O-insurance contract for the account of the authorized representative. Second, unlimited liability might even be considered if the employer, for the account of the authorized representative, enters into a D&O-insurance even though such cover is not required by the employment contract and/or the authorized representative did not even know about it.

In this (second) constellation, the following arguments can be submitted in order to establish unlimited liability of the authorized representative:

- The existence of D&O-cover leads to the conclusion that the issue of limited liability in favor of the employees is no longer of essential importance. The limited liability of employees developed by case law, primarily serves the protection of the employee's private assets. If insurance coverage exists, no such protection is needed any longer. Since there is no statutory limited liability of employees, sec. 276 para. 1 BGB applies in this case (resulting in unlimited liability even in case of simple negligence).
- Seeking D&O cover by the employer (insuring the risks of its authorized representative) is a comparable situation to the conclusion of an own „compulsory" personal liability insurance contract through the authorized representative.
- The wording used by some insurers in D&O terms whereby authorized representatives and executives are liable in accordance with "their personal liability based on labor court jurisdiction", does not lead to a contractual limitation of the employee's liability. The jurisdiction of labor courts is subject to continuous changes and is particularly to be interpreted in connection with above mentioned BAG decision

Against this, the following could be submitted:

- The German liability insurance law principle according to which coverage follows liability is breached. The so called (insurance law) separation principle ("Trennungsprinzip") leads to the differentiation between liability and coverage matters. The existence of insurance coverage therefore should not modify the liability situation of the authorized representative (resulting in an unlimited directors' liability even on second or even third management level).
- The D&O insurance would affect the opposite of what the contracting parties had in mind when entering the contract. With the co-insurance of authorized representatives in the D&O insurance contract, the contracting parties aimed to cover liability risks with reference to the limited liability of employees (cp. wording above: *"(…) their [the authorized representatives'] personal liability according to labor court jurisdiction*". However, by concluding the insurance, the parties do not intend to extend the authorized representatives' liability towards the company.
- The conclusion of a D&O-insurance contract by the employer has the same effect as the conclusion of a voluntary of professional liability insurance contract entered into by the employee. It is established that voluntary liability cover sought by the employee does not indicate that liability follows the so existing coverage (see 1.1). As a consequence, nothing else can apply if the employer enters into the (professional) liability insurance (by means of D&O-insurance) voluntarily for the account of its employee.

3. CONCLUSION

In due consideration of the latest labor court jurisdiction, it remains unclear whether and to what extent the conclusion of D&O insurance by a company may affect the liability situation of authorized representatives. The parties to the D&O insurance contract should clarify in advance how to deal with the consequences in case a court will decide an extended liability to the detriment of the authorized representative. One possibility could be not to include authorized representatives into the scope of D&O insurance cover. Professional liability insurance on a voluntary basis entered into by the authorized representative itself – which might then be agreed upon – would perhaps not affect the scope of liability.

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