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RECHTSANWÄLTE

Dr. Fabian Herdter, LL.M. Eur. Versicherungspraxis, December 2013

D&O Insurance

Coverage provided by one carrier? Connecting D&O and fidelity insurance

1. INTRODUCTION

Corruption and bribery in companies often raise the issue which insurance could be triggered and towards which insurance the company can notice the claim. This applies in particular where board members or managers are held responsible for (assumedly intentional) causation of losses through their own employees arising from lack of control and breaching of supervisory duties.

In such context, in particular D&O- and fidelity insurance could be triggered. In general, these two insurances provide cover for different risks. However, mainly in corruption and bribery cases overlaps appear. For example, Siemens AG entered into a published settlement with the respective D&O-insurers in the case of "black cash" and corruptions in 2010.[1] As far as the facts of this case became known to the public, also fidelity insurance (if existent) could have been triggered (even though no agreement with the fidelity insurer was published).

In the following, we summarize in short the differences between D&O and fidelity insurance and give a special view to the problem of overlapping between the two insurances as well as to the conclusion of whistleblower agreements (*Amnestieverein-*

[1] Cf. Published in the invitation to the annual general meeting 2010, http://www.siemens.com/investor/pool/de/investor_relations/events/hauptversammlung/2010/einladung_hv2010_d.pdf-

barungen). We explain to what extent it makes sense to coordinate and to streamline both insurances in order to establish only one risk carrier.

2. D&O- AND FIDELITY INSURANCE

D&O- and fidelity insurance differ fundamentally.

2.1 Concept of D&O- and fidelity insurance

German D&O-insurance is a (professional) liability insurance for managers, executives and board members (the insured persons) concluded by the company on behalf of its employees. If the company or an insured person gives notice of a claim under D&O-insurance, it has first to be examined whether the insured is liable to the (allegedly) aggrieved party. If the D&O-insurer assumes that the liability claim against the insured is not justified, the insurer must fight off the claim and indemnify defense costs – comparable to legal protection insurance. The insurer reimburses costs for lawyers, experts and court fees required to fight off the claim. The insurer will not pay any damages to the (allegedly) injured party as long as the question of liability is pending (if necessary until the court decides the matter in a final judgment).

In contrast, fidelity insurance covers financial losses of the company resulting from criminal acts committed by its own employees (often called “white collar crime”). The fidelity insurance, thus, particularly covers damages to the company resulting from tortious acts intentionally committed by a person of trust. The company seeks fidelity insurance at its own account (and not on behalf of a third person).

2.2 Different definition of the insured event

The insured event is defined differently in the D&O respectively fidelity insurance.

Pursuant to general D&O conditions, the insured event occurs when the claim is made against the insured person by the company (insured vs. insured) or by a third party (so called claims made principle – *Anspruchserhebungsprinzip*).

In fidelity insurance, however, the determination principle (*Feststellungsprinzip*) applies. Thus, the insured event occurs at that point in time when the company discovers the damage. The determination of the insured event therefore requires that the company suffered a damage committed by the person of trust and that this damage was discov-

ered during the term of the insurance contract. The insured event is considered as being discovered as soon as the policy holder becomes aware of the facts establishing the insured event.

2.3 Overlaps between D&O and fidelity insurance

The initial review and investigation of damage by the company – particularly in corruption and bribery cases – often makes it difficult to decide whether the case is subject to D&O- or fidelity insurance. This can be explained as follows:

The differentiation between D&O- and fidelity insurance is made with the requirement of intent (dolus directus) and gross negligence (in some conditions including conditional intent (*Eventualvorsatz*)).

D&O-insurance does not provide cover if the insured has intentionally committed a breach of duty or has consciously omitted to control and supervise the employees of the company. However, according to standard terms in the D&O-insurance, as long as a court did not finally hold a conscious breach of duty, the insured person does not have to reimburse defense costs already paid in advance by the insurer.

In the fidelity insurance the insured event occurs if the person of trust intentionally committed a tortious act. If the person of trust is an executive (thus member of the supervisory board, management board or in any other executive function), the insured event not only requires that the board member has been involved in the causation of damage but also that the executive enriched himself by violating the law.

> Example: Employee A trades with financial products on behalf of the bank B. A exceeds his authorities and uses customers' money for non-authorized financial transactions. A runs high risks and therefore initially makes high profits for B. Since A's salary is to a large extent based on business success, A reaches high bonuses. Manager C knows about A's investments, but he does not intervene.
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> At a later time, B suffers high losses caused by A's investments. B instructs the internal audit department and examines the damage. The result of the examination, inter alia, is that C breached his supervisory and control duties towards A and thus contributed to the damage. In the course of further investigations and by assessment of emails and other documents, it turns out that C did not only

know about A's way of doing, but also received – in return for keeping silent – part of the bonuses realized by A in cash.

In the case at hand, at the beginning of the investigations it seemed that C's omission to supervise and control A could trigger the D&O-insurance (in case a claim of B is made against C). Later investigations result in an exclusion of cover under the D&O-insurance (due to intentional breach of duty). The new findings, however, could trigger an insured event under the fidelity insurance.

2.4 Reasonable approach

If a company starts investigations and assesses the loss caused by the insured person respectively the person of trust, the following approach could be reasonable to comply with the different definitions and requirements of the insured event:

As a measure of precaution the company should notify the fidelity insurer about the damages discovered. According to the insurance terms of most fidelity insurances such insured event should be notified "immediately" after it has been discovered.

With respect to D&O-insurance, the company should examine whether a written claim against the insured (that triggers the insured event) is already made. If such a claim is made, the company should immediately notify the claim to the D&O-insurer. If this is not the case, the company should further examine whether the contract allows a notice of circumstances. If such clause exists, the policy holder (or an insured person) may notify circumstances to the insurer that could trigger a subsequent claim against the insured person. As a consequence, in case of a later claim, the claim would then be considered as if it had been made at the point of time the circumstances have been disclosed to the insurer.

In case of doubt when it remains open whether the insured person / person of trust acted with intent or with gross negligence and when the D&O-insurance has provided (provisional) defense cover to the insured person, the case might be proceeded under D&O-insurance at first. In the course of liability proceedings against the insured person, the company may find out whether and to what extent the insured person is liable. If it turns out that the insured person acted deliberately (and possibly with the intent of unjust enrichment), and, thus, D&O coverage is excluded, the company may refer the matter to fidelity insurance.

In order to avoid that possible claims under the fidelity insurance do not become time-barred, the company should agree with the fidelity insurer on a waiver of limitations. By this measure the company ensures that is may – at a latter point – trigger the fidelity insurance in case the insured person committed a deliberate breach of duty that excludes D&O-cover.

The acceptance for such approach is easier to achieve with the insurer if the company seeks D&O- and fidelity insurance cover from the same insurer. The company may then argue that the facts notified to the insurer "either way" fall within the scope of cover of one of the two insurances.

3. WHISTLE BLOWER AGREEMENT

Whistle blower agreements provided by the company to its employees can threaten insurance cover under D&O- and fidelity insurance.

Whistle blower agreements are often used in corruption and bribery cases (with cross-border implications) in order to facilitate the disclosure of facts for the aggrieved company. By making use of whistle blower agreements, the company requests its managers and other employees to fully disclose all the circumstances of the case under examination. In return, the company accepts to waive its right to assert claims for damages against these managers or other employees and to terminate employment contracts.

As a result, such waiver excludes liability proceedings of the company against the insured person (insured vs. insured claims) who agreed upon the conclusion of the whistle blower agreement. Accordingly, there are no remaining liability claims that could be subject to compensation by the D&O-insurance.

In case of joint and several liability, e.g. claims against several managers, authorized representatives, executive managers etc., it has to be carefully reviewed who has concluded with whom what kind of whistle blower agreement and how these agreements affect liability of other insured persons.

In addition, fidelity insurance also requires the company (with reference to sec. 86 para. 1 Insurance Contract Act (VVG)) to examine whether such whistle blower agreements exclude the insurer to make recourse claims against the person of trust who caused the damage. According to sec. 86 para. 1 VVG, the policy holder must assign its claims against the injuring party to the insurer insofar as the insurer compensates for the loss.

However, according to sec. 404 German Civil Code ("BGB"), the injuring party could raise the objections against the insurer (here: the release from claims by the whistle blower agreement) that were also justified against the company at the time of the assignment.

As a consequence, the insurer could be released from payment as the policy holder (the company) violated its obligation to uphold the insurer's recourse claims for compensation, sec. 86 para. 2 VVG. Any conduct that may cause in a loss of claim or avoids its realization is not allowed to the policy holder.[2] If the policy holder – in such context – only acts with gross negligence, the insurer's payments will be reduced commensurate with the severity of the fault.

Against this background, the company should not make use of whistle blower agreements with persons of trust without prior consent of the fidelity insurer.

4. SUMMARY

Companies should – whenever possible and in consideration of economic aspects – coordinate D&O- and fidelity insurance by making use of an identical risk carrier (or at least of an identical leading insurer).

As long as the question of intent has not been fully disclosed in corruption and bribery investigations the company should for reason of precaution notify the insured event with both (D&O- and Fidelity) insurers.

Whistle blower agreements can affect the issue of cover under D&O- and fidelity insurance. The company should therefore involve both insurers in the conclusion of such agreements.

Dr. Fabian Herdter, LL.M. Eur.
Lawyer
Master of European and International Business Laws

[2] Prölss in Prölss-Martin, Insurance Contract Act (VVG), 28th edition 2010, sec. 86 no. 36

Wilhelm
Partnerschaft von Rechtsanwälten mbB
Reichsstraße 43
40217 Düsseldorf

Telephone: + 49 (0)211 687746 - 50
Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de
fabian.herdter@wilhelm-rae.de

AG Essen: PR 1597