WILHELM

RECHTSANWÄLTE

Dr. Anja Mayer and Dr. Friedrich Isenbart

D&O Insurance

D&O liability within corporate groups – who is the injured party?

1. INTRODUCTION

In corporate groups with control and profit transfer agreements (hereafter: "affiliation agreements") the controlling company has the obligation to compensate any annual net loss of the controlled company (sec. 302 para. 1 German Stock Corporation Act).

Taking this into consideration, the existence of recoverable loss of the controlled company is often denied in D&O disputes (or other conflicts with regard to liability). According to such argumentation, a loss of the controlled company would be compensated anyway because of the affiliation agreement. Thus, the controlled company could not suffer any loss. After all, the controlled company would have had to transfer profits to the controlling company, if the impairment had not happened (sec. 291 para. 1, sec. 301 German Stock Corporation Act). A loss thus could arise only to the controlling company.

Against this background, the question arises, which company actually has suffered a loss and can consequently claim for damages?

Within the following examinations, we differentiate between two constellations:

A loss of the controlled company can be caused by a breach of duty of the company's own management (see below 3.). If a control agreement exists, a loss can also be caused by faulty instructions of the controlling company's management (sec. 309 para. 1 German Stock Corporation Act, see below 2.)

2. LOSS CAUSED BY MANAGEMENT OF THE CONTROLLING COMPANY

If a loss of the controlled company is caused by a faulty instruction of the controlling company's management, a claim for damages can be taken into account according to sec. 309 para. 2. German Stock Corporation Act.

Accordingly, the controlling company's legal representatives are liable if their instructions as per sec. 308 German Stock Corporation Act were issued without the care of a diligent and conscientious manager.

2.1 Loss of the controlling company

According to some opinion, the controlled company cannot suffer a loss by a faulty instruction of the controlling company's management. The loss compensation and profit transfer agreement would rather lead to a loss only on the controlling company's part. The effect would be that claims for damages by the controlled company according to sec. 309 para. 2 German Stock Corporation Act were not possible.

This would result from a loss calculation based on the balance method. Accordingly, the loss has to be calculated by comparing the actual financial situation after the breach of duty with the hypothetical financial situation of the company without the breach of duty. No real loss of assets on the controlled company's part due to the event would be recognizable. Instead, only the controlling company's profit would be reduced or the controlled company would be entitled to a claim for loss assumption according to sec. 302 para. 1 German Stock Corporation Act against the controlling company. Thus, a loss occurs only to the controlling company.

2.2 Loss of the controlled company

According to the preferable view, a loss compensation and profit transfer agreement must not to be considered when calculating the loss. A loss occurs only to the controlled company.

2.2.1 Ratio legis of sec. 309 German Stock Corporation Act

This view is supported by the ratio legis of sec. 309 German Stock Corporation Act. If a loss of the controlled company is denied due to the contractual compensation duty resulting from the profit transfer agreement, sec. 309 para. 2 German Stock Corporation

Act (which obliges to compensate for the loss of the controlled company) would have no area of application.

Moreover, it seems unreasonable to relieve the injuring party solely because of a contractual loss transfer within the group (from controlled to controlling company). The personal liability of the controlling company's management intended by sec. 309 German Stock Corporation Act would be circumvented.

Finally, it has to be taken into account, that the claim for damages on the basis of sec. 309 para. 2 German Stock Corporation Act directly follows the injuring event whereas a claim for loss compensation of the controlled company against the controlling company does not exist until the effective day of the annual accounts (and is only available after the approval of the annual accounts) as per to sec. 302 para. 1 German Stock Corporation Act. If the controlled company was limited to claim on the basis of sec. 302 para. 1 German Stock Corporation Act it would have to wait until approval of the annual accounts without being able to previously assert claims for damages against the controlling company's management.

2.2.2 No abatement of benefits

Also, the loss of the controlled company is not affected by an abatement of benefits after loss compensation.

The principles of the abatement of benefits only apply if the benefits resulting from the injuring event (i.e. of the breach of duty) were also caused in an adequate-causal manner.

This is though not given in the case of loss compensation due to an affiliation agreement. The loss compensation is not based on the breach of duty as injuring event (and is therefore not adequate-causal), but exclusively on the affiliation agreement (concluded independently thereof).

Furthermore, the affiliation agreement in most cases (though not necessarily) did already exist before the breach of duty as injuring event. Claims against third parties from obligations which existed before the occurrence of the injuring event principally cannot be adequate-causal benefits caused by the injuring event.

After all, loss compensation on the basis of an affiliation agreement does not constitute an adequate-casual benefit which might be credited to the controlling company's management. The personal liability of the controlling company's management towards the controlled company remains as intended by sec. 309 German Stock Corporation Act. Such liability would be pointless if an abatement of the benefits due to an affiliation agreement was possible.

3. LOSS CAUSED BY MANAGEMENT OF THE CONTROLLED COMPANY

Not only instructions by the controlling company's management according to sec. 309 para. 1 German Stock Corporation Act can cause a loss of the controlled company. A loss can also be caused by a breach of duty of the controlled company's own management. In this case a damage claim of the controlled company against its own management does not result from sec. 309 para. 2 German Stock Corporation Act, but from sec. 93 para. 2 German Stock Corporation Act and sec. 43 para. 2 Limited Liability Companies Act.

The problem of loss compensation on the basis of an existing affiliation agreement as per sec. 302 para. 1 German Stock Corporation Act arises also if the loss of the controlled company is caused by its own management.

In these cases it is not possible to refer directly to sec. 309 para. 2 German Stock Corporation Act and the opinions discussed. However, our respective assessments also apply in case of loss caused by the controlled company's management.

The purpose of sec. 93 para. 2 German Stock Corporation Act and sec. 43 para. 2 Limited Liability Companies Act is to protect company assets (here: the controlled company's assets) by prevention and compensation of loss.

This purpose would be circumvented if a manager acting in breach of his duty was able to profit from the loss compensation on the basis of the affiliation agreement. The personal responsibility of the management board (here: the controlled company's managers) intended by sec. 93 para. 2 German Stock Corporation Act and sec. 43 para. 2 Limited Liability Companies Act would be circumvented.

Any exoneration of the controlled company's management would be unreasonable. Affiliation agreements do not intend to avoid a personal responsibility of the management board. They rather serve to subordinate the controlled company under external man-

agement or to optimize tax. They do not serve the purpose of protecting the controlled company's management against personal responsibility. Thus, there is no abatement of benefits.

Further, also in this case it has to be taken into account, that the claim for damages on the basis of sec. 93 para. 2 German Stock Corporation Act and sec. 43 para. 2 Limited Liability Companies Act directly follows the injuring event whereas a claim for loss compensation of the controlled company against the controlling company does not exist until the effective day of the annual accounts (and is only available after the approval of the annual accounts) according to sec. 302 para. 1 German Stock Corporation Act. The controlled company cannot be forced to wait until approval of the annual accounts before asserting damage claims against its own management. It has to be entitled to claim for damages immediately after the loss occurred.

After all, it would be inconsistent to affirm a loss of the controlled company if it was caused by faulty instructions of the controlling company's management on the one hand and to deny a loss if it was caused by the controlled company's own management on the other hand. The loss compensation on the basis of the affiliation agreement does therefore not constitute a benefit that could be credited to the controlled company's management. The personal responsibility of the management towards the controlled company remains as intended by sec. 93 para. 2 German Stock Corporation Act and sec. 43 para. 2 Limited Liability Companies Act. No loss compensation on the basis of an affiliation agreement can be taken into account when calculating damage claims.

4. JUDGMENT OF THE FEDERAL COURT OF JUSTICE

The previously mentioned results correspond to the judgment of the Federal Court of Justice.

By order of 10th November 2011 (IX ZR 106/09) the Federal Court of Justice held that the duty to transfer profit and compensate loss is limited to the internal relationship between the controlling and the controlled company. The court dealt with a claim of a controlled company against a competitor.

The controlled company remains creditor and debtor of contractual and legal claims in its relationship to third parties regardless of existing affiliation agreements. A loss suffered by the controlled company remains a loss of the controlled company. It does not

become a loss of the controlling company after successful loss compensation within the group.

Therefore, claims for damages have to be asserted by the controlled company itself (and not by the controlling company). The controlled company' capacity to sue or to be sued as creditor or debtor of claims in relation to third parties remains unaffected. The Federal Court of Justice does not regard a principally possible assertion of damage claims by third parties as justified in this case (prior instances regarded such an assertion as justified in this case, Higher Regional Court Frankfurt, judgment of 7th May 2009 – 6 U 185/07).

In addition, the Federal Court of Justice explained that the controlling company's duty to assume loss according to sec. 302 para. 1 German Stock Corporation Act concerns the overall result of the business activity of the controlled company, not only individual business transactions that are moreover still unsettled and subject to litigation.

The argumentation of the Federal Court of Justice can also be applied to damage claims of the controlled company against its own management or against the controlling company's management.

The Federal Court of Justice had to decide on damage claims against a competitor, not against the management of the controlled or controlling company. Still, the clear statements of the Federal Court of Justice regarding loss assumption and capacity to sue also apply for damage claims of the controlled company against the management (regardless of whether it is the own management or the controlling company's management).

As a result, contractual loss compensation within a group is irrelevant for damage claims of the controlled company against its own management or the controlling company's management.

5. CONCLUSION

In D&O disputes it is commonly argued that the controlled company did not suffer a replaceable loss because all of its loss was transferred to the controlling company on a contractual basis. This argumentation is incorrect. Principally, the controlled company suffers the loss.

When calculating the loss, no loss compensation in the meaning of sec. 302 German Stock Corporation Act or profit transfer in the meaning of sec. 291 para. 1 and sec. 301 German Stock Corporation Act has to be taken into account. This applies for claims against the controlled company's own management as well as for claims against the controlling company's management.

Dr. Anja Mayer
Rechtsanwältin

Wilhelm
Partnerschaft von Rechtsanwälten
Reichsstraße 43
40217 Düsseldorf

Telefon: + 49 (0)211 687746 - 24
Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de
anja.mayer@wilhelm-rae.de

Dr. Friedrich Isenbart
Rechtsanwalt

Wilhelm
Partnerschaft von Rechtsanwälten
Reichsstraße 43
40217 Düsseldorf

Telefon: + 49 (0)211 687746 - 21

Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de
friedrich.isenbart@wilhelm-rae.de

AG Essen: PR 1597