WILHELM

RECHTSANWÄLTE

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Director's and officer's liability

Liability limitations under German law and consequences for the D&O-insurance

1. INTRODUCTION

To protect their decision makers, most companies hold a D&O insurance policy. However, in some cases this manager liability insurance cannot prevent a personal involvement of the insured manager in the damage. The sum insured may for instance be consumed after a previous or previously settled insured event caused by another manager. The insurer may also be exempted from payment (for example due to breaches of notification or obligation by the company).

In order to minimize the personal liability risk, decision makers try to find additional solutions, in particular agreements on limitation of liability and exemption from liability. The drafting of such agreements under German law and their implications on D&O-insurance coverage are explained in the following.

2. TERMS DEFINITION

Under German law it is necessary to distinguish between the (contractual) limitation of liability and the (contractual) exemption from liability.

2.1 Limitation of liability

A limitation of liability is based on an agreement between the debtor (here the manager) and the creditor (here the company), according to which the debtor is only liability in the insured event if a determined level of fault for the breach of duty is reached (e.g. gross negligence). If a creditor only breaches an obligation with a fault below the agreed level (e.g. manager acts only slightly negligent), the debtor (the company) has no claim for damages.

2.2 The exemption from liability

An exemption from liability, on the other hand, is based on an agreement between the debtor (manager) and any third party. In the agreement, the third party undertakes to stand up for the fault of a debtor towards a creditor (the company) up to a certain degree of fault. If the manager breaches an obligation and the degree of fault is below the agreed level, it is not the manager paying, but the third party will be liable to compensation to the

company according to sec. 267 BGB. From the company's point of view, the legal situation is not different to those without exemption from liability. From the manager's point of view, the exemption from liability is practically the same as a limitation of liability.

2.3 Distinction to waiver of liability, general adjustment, settlement and discharge

The forms of contractual limitation of liability and contractual exemption reduce the liability in the sense that the manager is only liable to certain levels of fault.

Other forms modify the manager's liability only after its occurrence. Thus, the company and the manager may agree on a waiver of liability in the insured event (after liability occurred). The possibility of such waiver of liability is limited for some kind of corporate forms (e.g. sec. 93 para. 4 s. 3 Stock Corporation Act, AktG). So-called general adjustment agreements (e.g. in termination agreements) are identical with a subsequent waiver.

A waiver effect is basically - at least in some corporate forms – considerable in the form of a discharge of the manager by the shareholders. However, in the case of a stock corporation (AG), the discharge does not contain any waiver of reimbursement claims (sec. 120 para. 2 s. 3 AktG).

Beyond that, the liability may subsequently be reduced by settlement between the company and the manager (sec. 779 German Civil Code, BGB). For some forms of corporation, also the option of a settlement is clearly limited (sec. 93 para. 4 s. 3 AktG).

3. LIABILITY LIMITATION

3.1 Function and applications

The limitation of liability is often an agreement between the company and the manager already made at the beginning of the collaboration. It is then usually recorded in the employment contract or in the statutes before the occurrence of an insured event. According to such an agreement, the decision maker is liable only from a certain degree of culpability, for example, from gross negligence. The company is then not entitled to any reimbursement claim against the manager if the manager causes damage only slightly negligently.

Whether such limitation liability is admissible depends on the form of corporation:

The Stock Corporation Act substantially excludes a limitation of liability for board members (members of the executive and supervisory board) of a stock corporation (sec. 93 para. 4 s. 3 AktG).

According to its wording, this provision only applies to the waiver of and the settlement about liability claims against board members. Since the provision shall protect the corporate's assets and (indirectly) the interest of its shareholders, this prohibition also applies to measures, which act just like a settlement agreement of a (partial) waiver to the corporation's claims for reimbursement against its board members. A prior agreement between the company and its decision takers about liability limitations is thus inadmissible.

For the limited liability company (GmbH) there is no such legal provision. The shareholders of a GmbH may principally decide in advance about

liability claims of the company.[1] Exceptions apply to claims for a prohibited repayment of deposits or due to a prohibited acquisition of own shares (sec. 43 para. 3 GmbHG). Likewise, a waiver of a liability of the managing director due to intent is ineffective according to sec. 276 para. 3 BGB. Beyond the above exceptions, the details of a permitted prior limitation of liability are controversial. We will deal with the question, whether a limitation of the general manager liability is also possible for grossly negligent action, below in cypher 5.

3.2 Consequences for company-own D&O-insurance

Liability limitation agreements may have an influence on the scope of cover of a D&O-insurance. In general, coverage affects liability. If the liability of a managing director towards the company is limited by liability limitation agreement or if no liability exists, the D&O-insurer argues as follows: An exemption of the managing director from liability claims of the company may only be considered in the scope in which the managing director is liable for the damage occurred due to his breach of duty. If the managing director is not liable due to a liability limitation, no exemption from damages may follow in favor of the company.

This argumentation cannot be rejected out of hand, as the D&O-insurance is a liability insurance that implies liability for the insured person.

The liability of the manager (and thus the coverage obligation of the D&O insurer) might be given under certain circumstances, however, if the manager committed the breach of duty with conditional intent (dolus eventualis) by "approvingly accepting" the breach of duty. A limitation of liability for intent is excluded by law in sec. 276 para. 3 BGB. In that case, the liability restriction would not apply, but the cover claim of the manager against the D&O-insurer would though apply.

If the company argues with an eventual intent in relation to the manager's breach of duty, this argumentation is risky, since the coverage for deliberate (intentional) breaches of duty is - unlike breaches of duty with contingent intent - expressly excluded in almost all D&O policies. It then depends on the differentiation between conditional intent and deliberate intent.

Newer policies include so-called (sublimated) own-damage clauses, which allow the company to receive compensation for its damage from the D&O-insurer even in the event of existing liability limitation agreements. According to these clauses, it is irrelevant whether an enforcement of the damage in the internal relationship with the manager is possible.[2]

4. LIABILITY EXEMPTION BY THIRD PARTIES

4.1 Function and application possibilities

The exemption from liability is an agreement between the manager and any third party (usually, but not necessarily, a shareholder) that has already been concluded prior to the occurrence of damage. Accordingly, the third party undertakes to indemnify the manager against certain claims for compensation of the company. If a claim arises for which the decision maker is liable, the indemnify-

[1] Siehe im einzelnen Fleischer, Münchener Kommentar GmbHG § 43 Rn. 298 ff m.w.N.

[2] Vgl. Herdter, D&O-Eigenschadenversicherung: Innovation zu Lasten der Versicherten?, VP Praxistipp Juli 2018.

ing third party pays the compensation (if necessary, directly) to the company.

In contrast to the limitation of liability, an exemption from liability in a stock company does not endanger the assets of the company and is therefore permissible. The argument that exemption from liability leads the decision-maker to riskier behavior does not get in the way. This would then also apply to the D&O-insurance, which is indisputably permissible.

The liability exemption is principally also possible in the limited liability company (GmbH). However, it is important to ensure that the manager does not get into a conflict of interest as a result of the exemption. Otherwise, the freelance shareholder could use the executive secretary for his individual purposes with reference to the exemption.

The exempting shareholder could otherwise use the managing director for its individual purposes with reference to the exemption.

4.2 Consequences for company-own D&O-insurance

The exemption from liability of a manager by a third party (of claims of the company against the manager) does not harm coverage. The exemption from liability does not legally lead to an omission of liability and the insurer not being liable to cover. The exemption from liability rather leads to the fully liable manager not paying for the damage himself, but to the third party compensating the damage (cf. sec. 267 BGB) - generally subordinate to the D&O-insurer, i.e. only if those does not pay.

The insurer then cannot refer to the (subordinated) exemption from liability agreement in the relationship of manager - third party.

Therefore, there can be no credit for the advantage of the third party in favor of the insurer. Otherwise, the manager who protects himself from the risks of his activity by exemption from liability would in the end be in a worse position than a naive manager who "only" trusts in the cover of the D&O-insurer.

In its judgment on D&O-insurance dated 13 April 2016, the Federal Court of Justice stated that the company is generally free to decide whether and to what extent to claim against the manager for any loss incurred and to which assets of the manager the company may get access by means of possible enforcement proceedings.

If liability insurance exists, the company may claim against the manager alone with regard to the possibility of gaining full access to the claimant's cover claim against his liability insurer.

The insurer then cannot rely on the fact that the "*insured event did not occur because the damaging party is personally not threatened to lose assets from which the liability insurance wants to protect him*." From the two judgments it can thus clearly be seen that the company will primarily get access to the cover claim of the manager against the D&O-insurer.

5. LIABILITY LIMITATION AND GROSS NEGLIGENCE

It is disputed to what degree of negligence the liability of the member of the executive board may be limited - whether the limitation of liability applies, for example, only for minor negligent

breaches of duty or even in case of gross negligence. According to the applicable view, an exemption from liability or limitation (if legally permissible) is permissible for slight negligence. By contrast, a waiver of the liability of the managing director due to intent is, according to sec. 276 para. 3 BGB, undisputedly not permissible. There is disagreement as to whether a limitation of liability is also possible for gross negligence.

The degree of negligence is usually judicially assessed and German courts set high standards of care for decision makers. Should a limitation of liability only be possible for slight negligence, the decision-maker would remain with calculable residual risk. In our opinion, a limitation of liability is therefore also possible for grossly negligent breaches of duty.

6. CONCLUSION

In Germany, liability limitations and exemptions are a regularly used element to minimize the manager's personal liability risk. Such an agreement usually complements the existing D&O-insurance coverage in favor of the manager.

However, it is essential to formulate such agreement clearly and to adapt it to the corporate legal structure and interests of the respective company. At the same time, the D&O-insurance cover provided by the company should take into account existing liability limits for members of the executive board.

From the company's point of view, liability limitation agreements can lead to a lack of compensation of the damage through the D&O-insurer due to missing liability.

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