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RECHTSANWÄLTE

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D&O insurance

Court redefines insured event in case of assignment of claim

A critical review of the decision of Higher Regional Court (OLG) Düsseldorf of 12th July 2013, I-4 U 149/11

1. INTRODUCTION

Damages notified under the D&O insurance in most cases are insured vs. insured claims. A company (policy holder) claims against its own (former or current) board members, managing directors or supervisory board members (insured persons). When a claim is made, the insured person is entitled to insurance coverage under the D&O-insurance. The insured person is entitled to a claim against the D&O-insurer for payment of defense costs in case the claim is unjustified (defense function) or to indemnification from justified damage claims (indemnification function of the D&O insurance). According to the applied general terms on insurance, the insured event usually occurs with the "first written claim made" against the insured person.

The alleged breach of duty committed by the insured person is not always severe enough to lead to a dismissal. Still, the company wants compensation for the damage caused by the breach of duty. However, the dispute about damages should not put a strain on the relationship between the company and the insured person. In other cases, the insured person has left the company already but does not possess sufficient assets to satisfy the company's damage claim. For these constellations, sec. 108 para. 2 Insurance Contract Act ("VVG") provides remedy.

Pursuant to sec. 108 para. 2, the assignment of the right of recourse against the insurer to a third party may not be ruled out by general terms on insurance. Reversely, this

means that the insured person can assign the right of recourse against the insurer concerning the raised claim to the injured third party. Through assignment, the right of recourse becomes a direct claim for payment of the injured party against the insurer.

In literature and practice it is heavily disputed whether sec. 108 para. 2 VVG is also applicable in D&O insurance in case of insured vs. insured cases.[1] Now, the Higher Regional Court (*Oberlandesgericht* "OLG") Düsseldorf for the first time had the chance to decide about the legitimacy of the assignment of the right of recourse under D&O insurance in case of a claim in an insured vs. insured case (judgment of 12 July 2013, File No. 1-4 U 1149/11).

2. DECISION OF THE OLG DÜSSELDORF

The OLG Düsseldorf had to decide on the following facts:

2.1 Facts

The policy holder (a German corporation) holds a D&O policy with the claimant, a German insurer. According to the general terms on insurance of the insurance contract, the insurer grants insurance coverage to board members, managers and directors of the policy holder and its affiliates when claims are being made "for the first time in writing" due to breach of duty. Furthermore, the general terms on insurance contain a provision according to which the assignment of the right of recourse to the injured party is permitted. Other assignments of claims from the insurance contract are forbidden unless the claims are finally established.

In 2008, the managing director and the authorized signatory of the foreign subsidiary of the policy holder placed currency forwards at different banks. Due to the specific character of the currency forwards, the foreign affiliate (the claimant) suffered a six-figure loss.

The claimant at first terminated the employment relationship with the authorized signatory and claimed out-of-court against the authorized signatory in writing due to various breaches of duty in connection with the currency forwards transactions. At the same time, the claimant informed the insurer about the occurrence of the insured event.

[1] Cf. representative *Herdter*, VP 2012, p. 168 et seqs.

The authorized signatory rejected the claim and referred among others to his liability limitation according to applicable labor law. During settlement negotiations, the insurer declared to pay for the loss not until determination of the liability by a court. The claimant declared that he was not interested in liability proceedings abroad due to the presumably given liability limitation. The claimant therefore announced towards the insurer that he intended to claim against the managing director, being liable for the occurred loss without limitations according to the applicable law.

When settlement negotiations failed in February 2010, the claimant filed a claim in writing against his managing director for breach of duty in connection with the currency forwards. In March 2010, the claimant informed the insurer about the occurrence of the insured event concerning the managing director. The claimant called on the insurer to settle the claim by 1 April 2010. On 1 April 2010, the managing director assigned the right of recourse against the insurer under the D&O policy to the claimant. The managing director remained employed with the claimant due to his special importance for the claimant's sales force.

When the insurer still denied his liability despite further payment requests and notification of the assignment, the claimant filed a claim for payment against the insurer in Germany.

During proceedings, the insurer referred to the inadmissibility of the assignment according to his general terms on insurance. According to the insurer, the claimant was not a "third party" in terms of the insurance contract. Moreover, the insurer argued that the assignment was ineffective due to collusion in the meaning of sec. 242 German Civil Code (BGB). According to the insurer, an insured event would however not be given since there was no "serious" claim against the insured person.

2.2 Decision of the Higher Regional Court Düsseldorf

According to the OLG Düsseldorf, sec. 108 para. 2 VVG also applies for the assignment of the right of recourse in D&O insurance and the assignment is admissible (below cypher 2.2.1). The court though dismissed the claim holding that the insured event did not occur because a serious claim was missing (below cypher 2.2.2). The OLG Düsseldorf permitted appeal. The decision is not yet final and binding.

2.2.1 Assignability of the right of recourse

The court held that sec. 108 para. 2 VVG is applicable on D&O insurance. D&O insurance covers insured events resulting from a damage committed by the policy holder (insured vs. insured cases). In insured vs. insured cases, the policy holder is inevitably the injured party. The assignment of claims to the injured party shall principally be possible pursuant to sec. 108 para. 2 VVG and may not be excluded by general terms on insurance.

An assignment is also not ineffective only because of possible collusion. The danger of collusion between the insured person and the policy holder exists independently of an assignment. Insured person and policy holder may not only make arrangements in case of direct proceedings between policy holder and insurer, but also in case of liability proceedings against the insured itself in order to justify the alleged liability claim.

2.2.2 No insured event

According to the court, the insured event however had never occurred. Pursuant to the general terms on insurance, a requirement for insurance payment is that claims are made against the insured person „in writing“. For this, it would not be sufficient that the policy holder brings a claim against the insured person only pro forma. The policy holder rather has to actually (seriously) bring a claim.

From the perspective of an objective third party (policy holder, insured person), the general terms on insurance were to be understood in such a way that a simple letter is not sufficient to constitute a (“serious”) claim. The insured person would rather have to be confronted with a claim for damages. An objective third person would not expect insurance payment if claims against the insured person were not to be pursued.

The court further held that according to established case law, it was acknowledged that the insured was only actually be claimed against if the claimant (damaged party) was determined to assert damage claims against the insured and if the claimant showed this decision in such a way that the claim against the insured can be understood as being serious.

A just possible or probable claim would therefore not constitute an insured event. The institution of legal proceedings would often constitute the insured event, but was not obligatory. These legal principles apply respectively for a claim against the insured person by the policy holder.

Usually, a letter by the claimant requesting compensation for damages constitutes a sufficient claim. This applies especially if the general terms on insurance do not contain any other requirement for the claim than written form. Irrespective of the written form, the assessment whether a serious claim is given or not is a matter to be decided by the judge on the basis of the circumstances of the individual case. The policy holder (claimant) bears the burden of evidence and proof of the existence of an actual claim.

In the case at hand, according to the court, the claimant did not intent to actually claim against the managing director personally. The claim against the insured person was rather made as a matter of form. The court assumed that there existed an agreement between claimant and insured person according to which a possible claim should not be enforced. Thus, the claim was only made to trigger the insurance payment. The interest of the damaged party (claimant) in the insurance payment is not sufficient to prove the seriousness of the claim. The insured risk in the D&O-insurance is the financial loss of the insured person. If such financial loss was not impending, a serious claim would be missing. The sum insured is not an independent part of the insured person's assets but serves to protect the insured person in case of the occurrence of an insured event.

According to the court, these requirements to the "quality" of the claim do not contradict the purpose of sec. 108 para. 2 VVG. By giving the possibility to assign the right of recourse according to sec. 108 para. 2 VVG, the legislator intended to protect the special relationship between injuring party and injured party. The insured policy holder was though not released from actually asserting claims against the insured person. In the case at hand, the claimant never intended to assert claims abroad. If it was clear right from the start that the policy holder only intended to assert claims against the insurer, the insured person was never exposed to a damage claim. The insured person therefore knew that the claims letter had the sole purpose of asserting claims against the insurer. According to the court, the policy holder never intended to enforce claims against the insured person. Against this background, the claims letter only served to purport seriousness.

Further indicators for a missing seriousness of the claim are, according to the court, the timing of the claim, the conduct of the insured person who did not object the claim but assigned the right of recourse and the further employment of the insured person with the claimant.

Among others, the claimant continued to employ the managing director. A termination of the employment contract is no requirement for insurance coverage. However, a further employment is unusual since the dispute about the claim puts a strain on the employment relationship and is especially harmful to the company. The court also took into account that the claimant terminated the employment of the authorized signatory. Finally, the claimant did not explain in how far it intended to enforce the claim against the managing director if the insurer did not pay.

3. EVALUATION

The OLG Düsseldorf decided the question about the assignment of the right of recourse in favor of the policy holder (below 3.1). However, the court's requirements for "seriousness" of a claim are questionable. They contradict the legislator's intention when granting the possibility of assignment (below 3.2).

3.1 Affirmation of possibility to assign

The affirmation of the possibility to assign the right of recourse in D&O insurance by the OLG Düsseldorf corresponds with the purpose of sec. 108 para. 2 VVG. The injured policy holder is also a third party in accordance with this provision. This is acknowledged for other areas of liability insurance as well. Sec. 108 para. 2 VVG does not distinguish between different kinds of liability insurance.

Sec. 108 para. 2 VVG intended to protect both the interests of the injured as well as of the injuring party. The assignment protects the legitimate interest of the injuring party in not rejecting the liability claim of the third party (injured party). The injuring party might be interested in referring the injured party to the insurer in order to safeguard a special relationship to the injured party (cf. reasons to the law of sec. 108 para. 2 VVG BT-Drs. 16/3945, p. 867). Further, sec. 108 para. 2 VVG intends to enable the injured party to claim directly against the insurer and to clarify the case without bearing the risk of insolvency of the injuring party (cf. reasons to the law of sec. 108 para. 2 VVG BT-Drs. 16/3945, p. 86 et seq.).

This function of sec. 108 para. 2 VVG also applies in D&O insurance. The manager does not want to burden his employment relationship with a dispute on liability for damages. Besides, the liability claims made by an injured company usually exceed the insured person's assets. The injured company is therefore interested in claiming directly against the

insurer. Against this background, the court's affirmation of the assignment is consequent.

3.2 „Serious" claim

The court's statements about the seriousness of the claim are not convincing. According to our view, the court's argumentation is contrary to the applicable general terms on insurance, to the law of general liability as well as to the purpose of sec. 108 para. 2 VVG. The court thus redefines the insured event in D&O-insurance contradicting the common system of liability insurance.

3.2.1 „Written form" of damage claim

Pursuant to the general terms on insurance, the „written" claim for damages is sufficient to trigger the policy. This formal point of time alone determines from which moment on (a) insurance coverage is granted to the insured person, (b) the duty of disclosure is initiated, (c) claims for legal protection and for indemnification are due and (d) the statutory limitation period begins.

3.2.2 No intention to enforce required

In general liability insurance, a claim is made when compensation for damages is seriously asserted. The assertion is serious if the injured party makes a claim which is not obviously joking. According to common opinion, an intention of the claimant to enforce the claim is not relevant. Claims aimed at a later amicable settlement or third party notices are seriously asserted (BGH NJW 2003, 2376 = VersR 2003, 900, *Langheid* in: Römer/Langheid, Versicherungsvertrag, 3rd Edition 2012, No. 9). However, in the case at hand, the court requested such intention to enforce when asking for an explanation of how the claimant intended to enforce the claim against the insured person if there was no assignment.

The court also misjudges that the claim for indemnification is part of the insured person's assets, if not its major part. With the assignment and assertion of the claim for indemnification against the insurer, the injured policy holder enforces his damage claim against the insured person.

3.2.3 Contradiction to the purpose of sec. 108 para. 2 VVG

The court's requirements contradict the purpose of sec. 108 para. 2 VVG.

By converting the "written form" into "seriousness", the court suggests that any assertion by means of assignment creates nothing more than the impression of an insured event. Assignments thus would help sham insured events. This is misleading. Whether the injured policy holder has a claim against the insured person (as injuring party) or not solely depends on whether a) the insured person committed a breach of duty, b) such breach of duty was culpable and c) such breach of duty caused damage to the policy holder. The only difference between D&O and general liability insurance is that the insured event does not already occur with the breach of duty / occurrence of damage or the oral assertion of the damage claim, but not until written assertion of the claim.

For this reason, the criterion „serious claim" should not be overstretched. Precisely because the policy holder does not wish a dispute with the insured person or because the insured person has no assets, the policy holder is allowed to agree on an assignment with the insured person. The "friendly" claim is thus the normal case assumed by sec. 108 VVG and not an alleged counterpart to the "serious" claim. With its opinion, the OLG Düsseldorf denies the purpose of sec. 108 para. 2 VVG.

3.2.4 Continued employment does not constitute evidence

The continued employment of the insured person is no evidence or indication for a missing "seriousness" of the claim. As the court correctly sets forth, the termination of the employment contract with the insured person is no requirement for insurance payment. D&O insurers themselves often offer legal protection against terminations due to breaches of duty.

The injured policy holder is even obliged to assert existing damage claims against the injuring party – independently from a continued employment. D&O insurance offers coverage for negligent damaging conduct. In such cases, the board member usually remains employed.

4. CONSEQUENCES AND PERSPECTIVES

Insured person can assign the right of recourse (claim for indemnification against the D&O insurer) to the injured company. Pursuant to sec. 108 para. 2 VVG, such assign-

ment cannot be excluded by general terms on insurance. The decision of the OLG Düsseldorf though causes severe legal uncertainties in case of assignment.

When consequently following the court's view, an assignment is de facto possible neither in D&O insurance nor in general liability insurance. This is contrary to the intention of the legislator. In the future, insurers will argue that a claim is not serious but friendly if the insured person remains employed with the policy holder and/or if the claim for payment is brought directly against the insurer on the basis of an assignment. Policy holders will get into a conflict between (possibly desired) continued employment of the insured person and obligatory assertion of damage claims. Insured persons will always be obliged to defend themselves against damage claims.

Hopefully, this issue will soon be clarified by the Federal Court of Justice.

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