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Implications of the German Restructuring Act on D&O-insurances

1. INTRODUCTION

The German Act for the Restructuring and Orderly Liquidation of Credit Institutions, for the Establishment of Restructuring Fund for Credit Institutions and for the Extension of the Limitation Period of Corporate Law Management Liability (**German Restructuring Act**) is an answer to the financial market crisis. It therefore primarily contains regulations for credit institutions.

Furthermore, the legislator regards the insufficient sense of responsibility of some managers as a cause of the financial market crisis[1]. The legislator wants to work against this by extending the limitation periods for the D&O-liability of stock-listed corporations. Accordingly, the so far five-year limitation period for the D&O-liability according to stock corporation law (sec. 93 para. 6 German Companies Act "AktG" old version) shall be extended to ten years. The same applies – independent of the legal form and the listing on the stock exchange – for credit institutions.

In the following we discuss the extension of the limitation period for the D&O-liability according to stock corporation law (2.) as well as the consequences for existing D&O-insurance contracts (3.).

2. EXTENSION OF THE LIMITATION OF D&O LIABILITY CLAIMS BY THE RESTRUCTURING ACT

The Restructuring Act came into effect on 15th December 2010 with the extension of the limitation period for listed corporations and credit institutions (Art. 17 of the Restructuring Act). It was announced in the Federal Law Gazette on 14th December 2010[2].

[1] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 1.
[2] Bundesgesetzblatt I, S. 1900 vom 14.12.2010.

2.1 Presentation of the legal regulation

In Article 6 the Restructuring Act extends the limitation of liability claims against board members resulting from sec. 93 AktG for listed corporations. Sec. 93 para. 6 AktG, new version, says:

> *„(6) Claims under the foregoing provisions shall be time barred after the expiration of a period of ten years for corporations that were listed on the stock-exchange at the point of time of the violation of the obligation, for other corporations after the expiration of a period of five years."*

Via the reference in sec. 116 s. 1 AktG the extension of the limitation also applies for members of the supervisory board of corporations listed on the stock exchange[3].

Independent of the legal form and the listing on the stock exchange, the Restructuring Act also extends the limitation of claims against board members of credit institutions (Art. 2 No. 16a Restructuring Act). The new sec. 52a of the German Banking Act ("KWG") says:

" Limitation of claims against board members of credit institutions

> *(1) Claims of credit institutions against managing directors and members of the supervisory or administration board resulting from the board position and the employment due to the violation of duty of care are time barred after the expiration of a period of ten years.*
> *(2) Paragraph 1 shall also be applied for claims occurred before 15th December 2010 which are not yet time barred."*

The new sec. 52a KWG applies both for credit institutions with the legal form "corporation", even if they are not listed on the stock exchange, and for credit institutions with other legal forms.

2.2 The legislator's motive

With the extension of the limitation of D&O liability claims, the legislator wishes to achieve a higher sense of responsibility of executive and supervisory boards. The legislator sees the orientation of some managers on short-time results as one reason for the crisis of the financial market[4]. At the same time, the wide-spread shareholdings do not lead to the required engagement and interest in order to achieve a timely disclosure of the boards' violations of obligations[5].

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[3] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 82.

[4] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 1, 81.
[5] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 81.

Finally, the disclosures often require time-consuming procedures[6]. For these reasons, the legislator regards the doubling of the limitation period for D&O-liability claims for stock-listed corporations and credit institutions as appropriate.

2.3 Relevant point of time – transitional regulation

The connecting factor for the extended limitation period is the corporation's listing on the stock exchange, i.e. the accreditation to the national and international regulated market (sec. 3 para. 2 AktG)[7], or the capacity as credit institution. The relevant point of time for the stock-listing or the capacity as credit institution is the point of time of the violation of the obligation. Only if the corporation was listed on the stock-exchange at the point of time the board member violated an obligation, the limitation period is extended to ten years. On the other hand, the five-year limitation remains if the listing on the stock-exchange was carried out after the violation of the obligation[8].

The ten-year limitation period does therefore only apply for corporations that have already been listed on the stock-exchange or were already credit institutions at the point of time the board member committed the violation of the obligation. If the corporation though was neither listed on the stock-exchange nor a credit institution at the point of time of the violation of the obligation, the limitation period is five years.

According to sec. 24 EGAktG new version the extension also applies for all claims that have already existed and were not barred when the Restructuring Act came into effect (Art. 7 Restructuring Act). For claims that were already barred when the Restructuring Act came into effect, the limitation period of five years remains. The same applies for credit institutions according to sec. 52a para. 2 KWG (Art. 2 No. 16a Restructuring Act).

Thus the five-year limitation period remains for all claims that were already barred on 15th December 2010. For all claims that were not barred on 15th December 2010, the limitation period (provided that the corporation is listed on the stock exchange or is a credit institution) extends to ten years.

3. IMPACTS OF THE EXTENSION OF THE LIMITATION PERIOD ON D&O CONTRACTS

The extension of the limitation period based on sec. 93 para. 6 AktG to ten years has impacts on existing D&O-contracts.

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[6] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 81.
[7] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 82.
[8] Regierungsbegründung zum RestrukturierungsG, BT-Drucks. 17/3024, S. 82.

D&O-contracts usually provide for extended clauses. Thereafter, a corporation may assert claims against the insurer for a determined time period after the termination of the employment as a board member and the consequent termination of the D&O-contract. The insurers formulate the extended clauses differently. In some cases the extended clause depends on the duration of the contract. In such cases an extended clause of one year may for example be agreed for a D&O-contract that has a period of one year. The maximum extended clause has so far been five years/60 months.

For a corporation the question arises whether an extended clause for an existing D&O-contract applies through interpretation (3.1.), resp. whether a claim against the insurer concerning the adaptation of the extended period exists (3.2.).

3.1 No (supplementary) contract interpretation

According to sec. 133, 157 BGB, extended clauses cannot be interpreted in such a way that the amendment of the law results in a ten year extended clause. Something else could only apply if the clause explicitly referred to the limitation period of the former sec. 93 para. 6 AktG. This case is unproblematic and does not require interpretation.

3.2 Right to contract adaptation according to sec. 313 para. 1 BGB

The corporation may have a right to a contract adaptation according to sec. 313 para. 1 BGB against the insurer. The right and its scope depend on the individual case.

The right resulting from sec. 313 para. 1 BGB depends on the interests and the perceptions of the contract parties. The contract parties of a D&O-contract are the corporation and the insurer.

3.2.1 Limitation according to sec. 93 para. 6 AktG, old version, must be the basis of the contract

The right to a contract adaptation according to sec. 313 para. 1 BGB requires a disturbed basis of a contract. The basis of a contract is determined by the circumstances of the contract.[9] For this, the mutual ideas of the parties at the time of the conclusion of the contract or the acceptance of existing and known circumstances are decisive, provided that the contract parties base their business will on these ideas.[10]

The concurrency of the extended liability period with the limitation regulations of sec. 93 para. 6 AktG old version is the basis of the contract if the parties agreed on an extended liability period of five years. In this case, both contracting parties had the idea and the interest to ensure insurance

[9] *Grüneberg* in: Palandt, 70. Auflage 2011, § 313 Rn. 2.
[10] BGH DStR 2006, 1807, 1808; BGH NJW 2005, 2069, 2071; BGH NJW 1995, 2031.

coverage until the end of the limitation period. The insurer could perceive the corporation's idea since the corporation usually demanded the five year extended liability period. As the insurer included the five year extended liability period into the D&O-contract, the insurer did not disagree with the concurrency.

3.2.2 No exclusion of the right due to risk distribution

The right to contract adaptation is excluded if the modified circumstances concern the risk of one of the parties[11]. Changes of the law are circumstances that none of the contract parties can influence. It is unreasonable to impose this risk to one of the parties.

3.2.3 Unpredictability of changes in the limitation period

The right to a contract adaptation according to sec. 313 para. 1 BGB requires the unpredictability of the changes[12]. The changes of the law resulting from the Restructuring Act was unpredictable. Something different might apply for those cases in which the contract parties already knew about the Restructuring Act.

3.2.4 Severe disturbance of the basis of a contract

The disturbance of the basis of a contract due to an extension of the limitation period, must be severe. A disturbance is severe if one or both parties would not have concluded the contract or only with a different content, if they had known about the amendments in advance[13]. Amendments to law are usually regarded as severe[14].

The corporation would have concluded the D&O-contract with a different content, namely an extended liability of ten years.

It is questionable whether the insurer would have offered a D&O-contract with an extended liability of ten years. The insurer is usually interested to be in a position where he can be claimed against for only a not too long time. It may though be assumed that the insurer would have offered a ten year extended liability against a payment of an extra premium. It remains to be seen, whether insurers will offer an extended liability of more than five years.

3.2.5 Unacceptability of the unadjusted contract

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[11] BGH NJW 2010, 1874,1877; BGH NJW 2006, 899, 902; *Stadler* in Jauernig, Bürgerliches Gesetzbuch, 13. Auflage 2009, § 313 Rn. 20; *Grüneberg* in: Palandt, 70. Auflage 2011, § 313 Rn. 19.
[12] BGH NJW 1981, 1668, 1669; *Grüneberg* in: Palandt, 70. Auflage 2011, § 313 Rn. 23.
[13] *Grüneberg* in: Palandt, 70 Auflage 2011, § 313 Rn. 18.
[14] BGH NJW 1980, 1912, 1918; *Grüneberg* in: Palandt, 70. Auflage 2011 § 313 Rn. 34.

It must be unacceptable for the corporation to hang on to the unadjusted D&O-contract. The unacceptability is determined by means of a comprehensive evaluation of interests considering all circumstances[15]. Hereby, the economic concernment of the parties must be considered[16].

For the corporation it is unacceptable to hang on to the unadjusted D&O-contract. Damages due to a violation of the board members' due diligence obligations can threaten the corporation's survival. Claims are usually not enforceable against board members due to their financial situation. The corporation wanted to relativise this risk by agreeing on an extended liability over the total limitation period. After the change of the law, a new gab exists.

The insurer would be confronted with the possibility to be claimed against for a period of another five years in case the D&O-contract was adjusted. This disadvantage could though be compensated by a premium payment by the corporation.

3.2.6 Scope of the right to adjustment

The scope of the right to adjustment depends on the individual case. A right to an adjustment to an extended liability of ten years exists for D&O-contracts which provide for an extended liability period of five years. In these cases, the parallelism of the extended liability and the limitation according to stock corporation law can be seen as the basis of the contract.

If the D&O-contract provides for a graduated extended liability, a corresponding expansion of the graduation might be considered. This applies though only if the maximum limit of the extended liability is five years according to the existing contract.

If an extended liability of less than five years was agreed, a right to adjustment does though not exist. The parallelism of the extended liability with the limitation according to stock corporation law has than not become the basis of the contract.

3.3 Is the corporation obliged to adjust the insurance contract?

If the corporation has a right to an adjustment of the insurance contract by the insurer, the further question arises whether the corporation is itself obliged to realize such adjustment.

3.3.1 Basic principle: no obligation to conclude a D&O-contract

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[15] BGH NJW 1995, 592, 594; *Grüneberg* in: Palandt, 70. Auflage 2011 § 313 Rn. 24.
[16] BGH NJW 1998, 3192, 3194; *Roth* in: Münchener Kommentar zum BGB, 5. Auflage 2007, § 313 Rn 70.

An obligation to conclude a D&O-contract is discussed considering two points of view. At first, such an obligation should exist on behalf of the board member to be insured (cypher 3.3.1.1), on the other hand it should consider the corporation's interests (cypher 3.3.1.2).

3.3.1.1 Right of the board member to the conclusion of a D&O-contract?

An obligation to conclude a D&O-contract on behalf of the board member and consequently a corresponding right of the board member, does not exist. The Federal Supreme Court has determined this for board members in case no deviant regulations exist within the articles[17]. The same applies for members of the executive board[18]. Also the wording of sec. 93 para. 2 of the Corporation Act and paragraph 3.8. of the German Corporate Governance Codex („In case the corporation closes…") indicates that the board member has no right to the conclusion of a D&O-contract.

3.3.1.2 Obligation to conclude a D&O-contract on behalf of the corporation?

There is also no obligation to conclude a D&O-contract on behalf of the corporation[19]. The wording of sec. 93 para. 2 Corporation Act (AktG) and para. 3.8 of the German Corporate Governance Codex does not indicate such an obligation. When including sec. 93 para. 2 s. 3 through the law about the Appropriateness of Management Board Compensation (VorstAG) the legislator emphasized that there is no obligation to conclude a D&O-contract[20].

3.3.2 Exemption: Obligation to conclude a D&O contract resulting from the articles of a company or the employment contract

As an exemption, the obligation to conclude a D&O-contract may result from the articles of a company[21] or the employment contract[22]. In this case the board member has a right to the conclusion of a D&O-contract as defined. Such an obligation may lead to the board member's right to an adjustment of the existing policy. This depends on the phrasing of the obligation. If the corporation commits itself for example to adjust the extended limitation period, the board member would have the right to an adjustment of the policy. This is different if the extended liability of an already existing D&O-contract was shorter than the limitation period. If an insurance „usual in the market" is agreed, the developments in the market are to be applied.

3.4 The corporation's own interest to adjust the D&O-insurance

[17] BGH NZG 2009, 550, 552.
[18] So die h.M. in der Literatur, s. *Fischer* in: Spindler/Stilz, AktG, 2. Auflage 2010, § 93 Rn. 237 m.w.N.
[19] So die h.M. in der Literatur, s. *Fischer* in: Spindler/Stilz AktG, 2. Auflage 2010, § 93 Rn. 236 m.w.N.
[20] Beschlussempfehlung des Rechtsausschusses zum VorstAG, BT-Drucks. 16/13433, S. 11.
[21] BGH NZG 2009, 550, 552.
[22] Lange, VersR 2010, 162, 163.

Even if no obligation to adjust the existing D&O-contract exists, the corporation should consider the economic value of the extended liability of insured claims for damages against board members.

4. CONSEQUENCES FOR THE PRACTICE

The extension of the limitation period to ten years has consequences for the enforceability of claims for damages of corporations against former board members. The corporations now have the possibility to enforce existing claims against former board members for five more years. The realization of this possibility is though relativized by the board member's financial capacity. The corporation can reduce this risk by adjusting the extended liability period. The corporation should though consider the costs resulting from the insurer's premium increase when deciding about the adjustment of the D&O-policy.

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