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Management Liability

Corporate Compliance, Executive Liability and D&O Insurance in Germany

November 14, 2018

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Corporate Compliance

The management's compliance duties

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The German Corporate Governance Code (Section 4.1.3):

- “The management board ensures that all provisions of law and the company’s internal policies are complied with, and endeavours to achieve their compliance by the group entities (compliance). It shall also institute appropriate measures reflecting the company’s risk situation and disclose the main features of those measures. Employees shall be given the opportunity to report, in a protected manner, suspected breaches of the law within the company, third parties should also be given this opportunity.”
- The Ethics & Compliance Initiative (ECI) issued a Report “Measuring the Impact of Ethics and Compliance Programs” (ECI Report).
- The report listed the following objectives for companies to strive towards:
- Leaders are expected and incentivized to personally act with integrity.
- Values and standards are clearly communicated.
- Leaders create an environment where employees are empowered to raise concerns.
- All employees are expected to act in line with company values, and are held accountable if they do not.
- Employees are provided guidance and support for handling key risk areas.
- Disciplinary action is consistently taken against violators.

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The German Corporate Governance Code (Section 4.1.3):

- Investigations are objective, consistent, and fair to all parties.
- The organization provides broad and varied avenues for reporting.
- The organization appropriately discloses wrongdoing to authorities.
- Key risk areas are identified through a robust assessment process.
- In the landmark Siemens/Neubürger judgement, the District Court Munich addressed in detail the requirements for a compliance organisation as well as the related obligations of the management board.
- The management board's responsibility in the event of suspected compliance cases coming to light can be described as a 'three-fold obligation':
- First, the obligation to clarify the case (detect).
- Second, the obligation to put an end to unlawful behaviour.
- Third, the obligation to impose appropriate sanctions in response to violations that have been discovered.

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The Basic Principles of Management Liability

1. Introduction

- Highly litigious environment
- Dot-com crash and financial crisis boosted civil and criminal court cases with high public attention
- Courts have interpreted management duties stringently over the past years
- Increasing standards for compliance management systems
- Steadily increasing range of tasks for the supervisory board

2. Internal and external liability

- In most cases liability claims are raised by the company against its (former) management
- Liability claims of third parties against the management are less frequent
- Board members are jointly and severally liable for breaches of their duties vis-à-vis the company
- In lawsuits against the management, the company is represented by its supervisory board
- The supervisory board is obliged to pursue viable claims

3. Liability is unrestricted

- The liability of board members is generally unrestricted
- The managers are liable for the entire damage even in cases of slightest negligence
- Board members may avoid liability under the business judgment rule only if the following preconditions are fulfilled:
  - Discretionary business decision
  - Acting for the benefit of the company and in good faith
  - No inappropriate considerations
  - Careful investigation of all relevant facts

4. Burden of proof

- The burden of proof rests with the (former) management
- The (former) management has to prove that it did not breach any management duty and/or it did not act culpably
- No discovery or disclosure proceedings under German civil procedural law
- Scope of disclosure duties of the company vis-à-vis the (former) management highly controversial

5. Limitation of liability and settlement 1/2

- In GmbHs
  - In the employment contract limitations of liability are permissible
  - Settlement agreements are permissible and shareholders may decide not to pursue viable claims against the management
  - No liability if the management has acted in line with the lawful instructions of the shareholders

5. Limitation of liability and settlement 2/2

- In AGs
  - In the employment contract limitations of liability are NOT permissible
  - Settlement agreements are permissible only under limited circumstances:

    Only three years after the claims have arisen and only if the general assembly consents and no minority whose aggregate holding equals or exceeds 10% of the share capital records an objection in the minutes
  - The supervisory board is required to pursue viable claims
  - No liability if the management has acted in line with the lawful instructions of the general assembly ←→ approval of supervisory board does not exclude liability

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D&O-Insurance in Germany

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D&O-Insurance in Germany

- More than 50,000 German companies holding D&O policies today.
- More than 50 D&O insurers competing for D&O contracts.
- D&O insurance pricing overall has declined in the last years.
- Claims ratios for most D&O insurers are short of catastrophic.
- Given the continued abundance of insurance capacity, insurers pushing for rate increases will be facing some powerful headwinds.
- Recent changes of importance in the wording of D&O policies are in the exclusions:
- Cover is often restricted with regard to the recovery of damages after payment of administrative fines against the company, antitrust violations, corruption and most recently 'fake president fraud’.

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D&O-Insurance in Germany

- **The following parameters are of paramount importance for effective protection:**

- **Insurance Sum**
- A risk-orientated, sufficiently high insurance sum is a crucial matter.
- A distribution problem arises as soon as the fixed insurance sum proves to be insufficient.
- The insurer’s duty to pay proceeds within an insurance period is limited to the documented insurance sum per insurance case and for all insurance cases in the aggregate.
- High legal expenses to defend the claim are credited against the insured limit.
- **Network of D&O-Expert Attorneys**
- High-quality D&O conditions provide that the choice of counsel and the fee agreement do not hinge on a consensus with the D&O insurer, as long as the lawyer is retained via a highly specialised lawyers’ network.
- The insurer’s fee guarantee should be tantamount to the usual hourly rates of prestigious lawyers in the field.

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D&O-Insurance in Germany

- **The following parameters are of paramount importance for effective protection:**

- **Arbitration Proceedings**
- New practical rules of arbitration tailored to the needs of executive liability cases will help to reach a decision on complex disputes in less than twelve months.
- Essential are highly qualified arbitrators for the swift and cost-effective solution of D&O disputes.
- The arbitration award is legally binding, because there are no appeals against arbitral awards.
- Because the D&O insurer also participates in the multiparty procedure, the insurer must recognize the arbitral award and pay accordingly.

- **Cover in the event of set-off**
- Evermore frequently, it is noted that the policyholder declares that claims relating to employment contracts, in particular salaries and pension benefits are to be offset against liability claims which would be insured within the scope of the terms of the D&O Policy.
- Good D&O Policy Wordings include provisions which enable continuing salary payments and assume severance payments.

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D&O-Insurance in Germany

- **The following parameters are of paramount importance for effective protection:**

- **Guarantee of Continuity**
- D&O policies are based on the ‘claims made principle’.
- The Guarantee of Continuity provision stipulates that if the policy is continued with restrictions on its conditions and/or a reduced limit of indemnity, then, with regard to breaches of duty committed prior to the commencement of the amendment, the original scope of cover applies as agreed immediately prior to the restriction of cover and/or reduction in limit of indemnity.

- **Extended Reporting Period**
- Management Liability claims for Managing Directors of a Limited Liability Company and Executive Board Members of a Stock Company become time-barred and lapse in five years.
- In the event the company is listed on the stock exchange, the claims lapse in ten years.
- The Extended Reporting Period needs to be sufficient.
- Best corporate D&O-Policy Wordings stipulate a 144-month extended reporting period.

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D&O-Insurance in Germany

- **The following parameters are of paramount importance for effective protection:**

- **Two-Tier Trigger Policy**
- Separate D&O insurance for supervisory boards is downright essential in the German two-tier board system.
- In liability proceedings, an executive board tends to react according to the motto “attack is the best form of defence” and threatens the supervisory board with recourse claims for contribution predicated on connivance and co-responsibility.
- In the case of third-party notices, the D&O insurer shall refrain from simultaneously representing the opposing interests of defendant executive board members and notified supervisory board members.
- Ancillary to an existing policy for executive (and supervisory) board members, a company should put up a protective umbrella for the supervisory board members via separate supervisory board D&O insurance coverage with an independent insurer to resolve the conflict of interests (two-tier trigger policy).

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D&O-Insurance in Germany

- **The following parameters are of paramount importance for effective protection:**

- **D&O insurance at one's own expense**
- Personal D&O insurance which is also called individual D&O has revived the German D&O-insurance market in the last years.
- The need for personal D&O-Insurance is most understandable in the worst case scenario with the consumption of the D&O insurance limit.
- The private D&O insurance is subsidiary to the insurance cover of the company policy.
- Personal cover is always used when the insurer of the company refuses to provide cover - for whatever reason.
- The personal D&O insurance can be extented to the statutory D&O deductible for Management Board members.
- Corporate D&O Policies shall provide for a deductible of no less than 10 per cent of the damage up to at least an amount equal to 1.5 times the fixed annual compensation of the managing board member.
- For supervisory board members, it is possible to extend coverage for several mandates in different companies via a single Personal D&O Policy.

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