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Guest Post: D&O Insurance on the Agenda of Shareholders' Meetings in Germany

By Kevin LaCroix on May 6, 2015
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In the following guest post, Dr. Burkhard Fassbach and Dr. Niklas Rahlmeyer imagine a possible shareholder presentation about D&O insurance at an annual meeting of shareholders in Germany. Fassbach is an Of Counsel with the Dusseldorf based D&O-Specialist Law Firm Hendricks. Rahlmeyer is an attorney in the corporate practice group of the Dusseldorf office of Field Fisher Waterhouse LLP. I would like to thank both for their willingness to publish their guest post on this site. I welcome guest post submissions from responsible authors on topics of interest to readers of this blog. Here is the guest post.

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In the wake of a significant increase of D&O claims, (activist) shareholders are determined to meticulously scrutinize D&O policies at shareholders' meetings. The chairs presiding at such meetings as well as members of the supervisory and the executive board should be prepared accordingly.

The shareholders are likely to chime in with the following:

"Dear Mr. Chair, dear supervisory and executive board members,

as a stockholder of this corporation, I rise to speak at our today's shareholder meeting so as to discuss the topic of D&O insurance. As you are all well aware, the D&O insurer's promise to defend its insureds against unfounded claims for damages is at the heart of the insurance contract. If these claims turn out to be valid, the insurer's ensuing duty is to indemnify its insureds by effecting payment to the policyholder. According to case law, the insurer's promises to both defend and indemnify are conterminous and based on equal legal footing.

As a shareholder, I am deeply troubled with whether the D&O insurance coverage taken out for our company is going to protect our corporation's assets when the chips are down. Please recall the slush funds at Siemens. In that case, where the damage amounted to EUR 1.6 billion and the insurance sum was set at EUR 250 million, the insurance carriers eventually paid out the petty amount of EUR 100 million. I, personally, am incapable of discerning asset protection here. Likewise, the shareholders of Deutsche Bank will have to dig deep into their pockets. When former chair Breuer, during a Bloomberg TV interview, rendered detrimental comments relating to media entrepreneur Kirch, this cost Deutsche Bank EUR 925 million. It is the shareholders who are most likely going to have to foot the bill resulting from this squander of capital.

As you all know: Executive board members and supervisory board members who commit a breach of duty are jointly and severally liable to the corporation for such damages as result from their breach of duty. Don't get me wrong, dear members of the executive board: I have complete trust in the way you are conducting business. However, as a shareholder, I ought not to lose sight of the worst-case scenario. Since the worst case did not spare former icons of the German economy, it is potentially not going to halt here.

My first inquiry is this: Do you deem the insurance sum of the D&O policy that is currently in place appropriate with respect to the risks our company is exposed to? Secondly: Have you concentrated on analyzing current developments in the D&O insurance arena in Germany? Please bear with me while I would like to render some background information in this regard:

The product of D&O insurance has its origin in the U.S. Unlike German law, U.S. law does not know an institution alized separation of monitoring and management. As a consequence of the nonreflecting adoption of American coverage concepts in Germany, both the executive and the supervisory board members are insured persons that are commonly insured under the roof of the identical insurer.

Can this work? I raise this question, because, in a D&O damage event, members of the supervisory board and members of the executive board are potentially prone to having colliding interests. Reasoning that attack is the best form of defense, defendant members of the executive board, in a virtual routine of behavior, serve third-party notices on their supervisory board colleagues. To put it crudely: The D&O insurer then 'represents' two opposing parties. In this case, the insurer is ensnared in an inherent conflict of interest. The only viable solution is to separate one party from the representing insurer.

This flows from the precept that, in accordance with the legal precedents set forth by Civil Division IV of the German Federal Supreme Court in charge of insurance law matters, the insurer shall protect the interests of the insured person in the same way a lawyer retained by that person would do. On these grounds, insurance coverage concepts are under debate in Germany that forestall conflicts of interest between executive and supervisory board members. Following those concepts, insurance coverage for both organs is separately placed with different carriers. In D&O lingo this is called 'Twin-Tower' or 'Two-Tier-Trigger'-concept.

There are strong arguments backing this concept: It is upon the supervisory board to monitor management. The inherent crux of this duty to monitor has been appositely couched in an expert opinion to the 70th German Legal Colloquium. May I quote: 'As the monitoring of management rests with the supervisory board, any mistake made by management is theoretically susceptible to being converted into a mistake by the supervisory board', which amounts to the statement that, had the supervisory board lived up to its monitoring duty, the mistake would have been averted in the first place.

According to the German Federal Supreme Court's 'ARAG doctrine', a supervisory board is subject to the duty to independently investigate the viability of a corporation's compensation claims against executive board members. the supervisory board does not fulfill its duty to pursue viable claims, this constitutes a breach of duty vis-à-vis th corporation, and the corporation, in turn, has a claim against the blundering supervisory board members.

The question inevitably becomes: Is it apt to perceive the supervisory board as a huntsman such as would reflect the ideal laid down by the German Federal Supreme Court? Or does the supervisory board feel inhibited due to po tentially becoming the hounded through third-party notices? Indeed, the supervisory board's independence with respect to the review of potential claims and their out-of-court assertion is most naturally heavily compromised fo 'fear of third-party notices'.

The residual risk bearers, the shareholders, take the greatest interest in the replenishment of the assets of the damaged corporation. Accordingly, we, the shareholders, take a fundamental interest in a supervisory board's act ing independently. For that matter, separate D&O coverage for members of the supervisory board works as a valu able contribution to effective corporate governance, because the supervisory board's independence in pursuing claims against executive board members is ensured at the level of D&O insurance. Thus, I ask you: Do you share my view in light of a shareholder-value concept?

Thank you very much for your attention."