COMMENTARY

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IN SHORT

The Situation: Claims brought by insolvency administrators under Section 64 of the German Limited Liability Companies Act ("GmbHG") are not only among the most common, but also the most financially significant, claims faced by the directors of distressed German companies.

The Development: In a landmark decision, the Higher Regional Court of Düsseldorf recently determined that claims brought under Section 64 of the GmbHG are not covered by insuring provisions found in many D&O insurance policies.

Looking Ahead: Commercial policyholders with German operations should proactively review and, if necessary, consider modifying their D&O insurance programs to guard against the risk of similar future rulings.

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Under Section 64 of the GmbHG, managing directors of limited liability companies are personally liable for any payments by the company after the onset of insolvency unless made with the "due care" of a prudent businessperson – a stringently applied standard that has proven difficult for German directors to satisfy.

Yet, in a landmark decision that could significantly impact the insurance landscape for German insolvency proceedings, the Higher Regional Court of Düsseldorf recently held that claims brought under Section 64 of the GmbHG are not covered by insuring provisions commonly found in many directors and officers ("D&O") insurance policies. (OLG Düsseldorf, Ref. I-4 U 93/16).

The Higher Regional Court of Düsseldorf's Decision

In the case in question, a managing director had sought indemnification from its D&O insurer for a €221,801.47 judgment in connection with Section 64 claims successfully brought against her by the company's insolvency administrator.

In the ensuing insuring coverage proceeding, despite the fact that the D&O policy lacked an express exclusion for Section 64 claims, the Düsseldorf court declined to find coverage, concluding that Section 64 claims were nevertheless beyond the scope of the policy's coverage granting provisions.

The D&O policy at issue provided coverage for any "damages claims" on account of "financial loss" made against the director by the company or a third party, including any insolvency administrator.

Evaluating this policy language, the Düsseldorf court concluded that Section 64 claims do not constitute "damages claims" but instead amount to "*sui generis*" claims of their own kind not encompassed by the Policy's coverage granting provisions.

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In support of its decision, the Düsseldorf court reasoned that Section 64 of the GmbHG is intended to preserve the insolvency estate for the company's creditors, not to indemnify the company for any actual damages suffered, and that a valid Section 64 claim does not require the company itself to have suffered any damages.

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Implications for Policyholders

The Düsseldorf court's questionable ruling is expected to receive its fair share of criticism, including that it failed to properly apply the fundamental principles of insurance policy interpretation that coverage granting provisions are to be construed broadly in favor of coverage and in accordance with the reasonable expectations of the policy's insureds.

Indeed, given the frequency and severity of Section 64 claims, a D&O insurer that had actually intended to exclude coverage for these claims arguably would (and should) have expressly done so, consistent with an insurer's general obligation to set forth limitations on coverage in clear and unmistakable language. By reading such an unstated limitation into the insurance contract, however, the Düsseldorf court's ruling appears to have overlooked this most basic tenet of insurance policy interpretation.

Nevertheless, it remains to be seen whether the Düsseldorf court's ruling would withstand scrutiny by the German Supreme Court or will be adopted by other German courts.

Given the significant increase in personal liability exposure to German directors and the potential reduction in bankruptcy estate recoveries that would result from the absence of coverage for Section 64 claims, commercial policyholders with German operations should therefore proactively review and, if necessary, consider modifying their D&O insurance programs to guard against the risk of similar future rulings.

TWO KEY TAKEAWAYS

1. In a landmark ruling, the Higher Regional Court of Düsseldorf recently determined that claims routinely brought by insolvency administrators against German directors under Section 64 of the GmbHG are not covered by general insuring provisions commonly found in many D&O insurance policies.
2. Commercial policyholders with German operations should therefore proactively review and, if necessary, consider modifying their D&O insurance programs to: (i) expressly cover claims brought under Section 64 of the GmbHG and the analogous Section 92(2) of the Stock Corporation Act and (ii) ensure that any "insured vs. insured" exclusions are subject to a broad "carve-back" that preserves coverage for claims brought by insolvency administrators and any other representatives of the company's bankruptcy estate.

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