INSURANCE - GERMANY

Federal Court of Justice rules on policyholder's insolvency under D&O insurance policy

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The Federal Court of Justice recently examined the consequences of a policyholder's insolvency under a directors' and officers' (D&O) insurance policy.(1)

Facts

Until 6 December 2010, the plaintiff was a managing director of a company that had taken out D&O insurance with the defendant. The policy stipulated that only the insureds could assert a claim for insurance cover. On 18 May 2011 the defendant terminated the insurance contract after the company failed to pay the annual premium despite the defendant's request.

On 1 May 2011 insolvency proceedings began with respect to the company's assets. The insolvency administrator claimed payment of damages from the plaintiff due to his management with regard to the company's deficient workmanship, for which the principal refused payment.

The plaintiff demanded cover from the defendant on the basis that the D&O insurance policy indemnified him against liability claims asserted against him by the insolvency administrator.

Decision

The court of appeal ruled that a claim of insurance cover was unenforceable due to the pending insolvency proceedings regarding the company's assets. The Federal Court of Justice overturned the ruling of the court of appeal.

In the case of insurance for a third-party account, the policyholder is authorised to dispose of the rights under the insurance policy in accordance with Sections 44(2) and 45(1) of the Insurance Contract Law. On insolvency of the policyholder, its power of disposal is transferred to the insolvency administrator pursuant to Section 80(1) of the Insolvency Statute. The insolvency administrator then decides whether the insurance contract will be fulfilled according to Section 103 of the Insolvency Statute.

However, according to Section 44(1) of the Insurance Contract Law, the insured is entitled to the rights under an insurance contract. Therefore, a claim for insurance cover is not part of the policyholder's insolvency estate. Thus, the insured has a right to segregation in accordance with Sections 47 and 48 of the Insolvency Statute.

A common theme in German D&O insurance policies that was relevant in the present case is that the policyholder – which was the company and former employer of the plaintiff in this case – has no power of disposal. Pursuant to the wording of the insurance conditions, claims for insurance cover can be asserted only by the insured. According to the Federal Supreme Court, such a provision is to be interpreted to the effect that it is intended to waive Sections 44(2) and 45(1) of the Insurance Contract Law, with the consequence that the policyholder is not entitled to the rights under the insurance policy. According to the court, the average policyholder and insured person – which are decisive when construing insurance conditions for third-party accounts according to German law – would have to comprehend the insurance conditions in the way that the relevant provision of the insurance conditions would not repeat the law but modify it. While the legal regulation deals only with the ownership of the right, the insurance conditions in the present case regulate its assertion. As only the insured can assert a claim, the regulations in Sections 44(2) and 45(1) of the Insurance Contract Law are waived in this respect.

Hence, the company's insolvency was irrelevant for the assertion of the claim. Therefore, the

insolvency administrator had no right of choice or fulfilment of the insurance contract or denial under Section 103 of the Insolvency Statute.

The Federal Court of Justice overturned this ruling and referred the case back to the higher regional court. The higher regional court must rule on the questions of:

- when the insured event occurred; and
- whether the insurer is free of liability due to default of payment.

Comment

Notably, the present ruling clarified that the insured person's rights under D&O insurance policies remain the same irrespective of the policyholder's insolvency. As policyholders' insolvencies often lead to liability claims against the (former) management, such situation is one of the most important matters for D&O insurance policies to cover. In addition, German D&O insurance conditions usually waive Sections 44(2) and 45(1) of the Insurance Contract Law and entitle the insured – and only the insured –to assert a claim for insurance cover; otherwise, D&O insurance policies would be unnecessary for insureds if the company as policyholder held a manager liable and could deny the assertion of the claim at the same time.

The Federal Court of Justice had already ruled on a similar clause in 2017.(2) However, at that time, it had considered an action by the insolvency administrator to be admissible. In that case, the insured also had the power of disposal over the claim for cover, but remained inactive and did not assert this claim. Therefore, according to the principle of good faith, the policyholder's insolvency administrator was entitled to assert the claim in order to protect it from the statute of limitations.

Therefore, the present verdict was a much-needed clarification.

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Endnotes

(1) 4 March 2020, IV ZR 110/19.

(2) 5 May 2017, IV ZR 360/15.