Simon Deakin, Helmut Koziol, Olaf Riss (eds)
Directors' & Officers' (D&O) Liability

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Directors' & Officers' (D&O) Liability

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Preface

In recent years several cases concerning the liability of directors and officers have courted controversy. Arguments raised in such discussions oscillate between two extremes: on the one hand, the need for boards of directors and other governing bodies to allow space to entrepreneurial discretion and, on the other hand, the need to ensure the protection of investors in and creditors of a company from the consequences of disadvantageous decisions by those bodies. Therefore, the editors were glad that the representative of the Munich Re in the Supervisory Board of the European Centre of Tort and Insurance Law (ECTIL), Ina Ebert, encouraged us to undertake a comprehensive comparative study on directors' and officers' liability in different legal systems and from various legal and economic aspects. Based on this proposal, an extensive questionnaire was sent out to the project participants in March 2015. This book presents the results of the project. It was funded under the generous auspices of the B&C Privatstiftung and conducted by the European Centre of Tort and Insurance Law (ECTIL) and the Institute for European Tort Law of the Austrian Academy of Sciences and the University of Graz (ETL).

In the study, directors' and officers' liability was examined from fourteen national perspectives (those of Austria, Brazil, the Czech Republic, Germany, Israel, Italy, the Netherlands, Norway, Poland, Spain, Switzerland, Turkey, the United Kingdom, and the United States). However, the volume does not only contain reports from key jurisdictions. Due to the economic importance of the topic, we also included a chapter on the economic analysis of directors' and officers' liability as well as a report from an insurer's point of view, as well as a report on Private International Law. Furthermore, the editors were pleased that the Austrian Industrial Association agreed to cooperate; therefore, a chapter on the perspective of entrepreneurs is also included.

The country reports were completed by the end of 2016. The special reports – most of which build upon the findings of the national reports – were subsequently drafted and finished by spring 2017. The authors of the country reports were then given the chance to update their reports up to June 2017.

The editors – also on behalf of ECTIL and ETL – express their gratitude to the B&C Privatstiftung for their generous support and to the Vienna University of Economics and Business (WU) for hosting the public conference, which took place, with the aim of presenting and discussing the results of the study, on 28 March 2017. We would also like to thank Fiona Salter-Townshend and Donna Stockenhuber for taking over the time-consuming task of proof-reading the entire manuscript, Kathrin Karner-Strobach for formatting and copy-editing and

David Messner, Alexander Longin and Vanessa Wilcox for their very dedicated assistance in organising the whole project and for compiling the Index. Without their invaluable help, it would have been impossible to bring this volume to publication in such a timely way. Additionally, we thank the whole staff of ECTIL and ETL for their help with the conference, in particular Lisa Zeiler for organising the conference and Julian Pehm for supporting the conference with his graphics expertise.

Cambridge/Vienna/Linz, August 2017

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Helmut Koziol
Olaf Riss

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Directors' and Officers' Liability Questionnaire

I. General Part – Overview of the Corporate Law Framework

1. Which legal forms of a company does your national law provide for? Is there a numerus clausus for these legal forms? Does the law draw a distinction between a private company (normally meaning one whose shares may not be publicly issued or traded) and a public company (normally meaning one whose shares may be publicly issued and traded, if it has also met relevant listing requirements)? If yes, what are the further implications of such a distinction (for example, does the content of directors' duties differ in the cases of private and public companies)?
2. Please provide a short comparison of the legal forms of a company with respect to the following characteristics:
   - Does the legal form in question possess legal personality?
   - Is there a separation of the company's property from the shareholders'/partners' property in the legal form in question (principle of separation of property)?
   - Are shareholders/partners liable for debts of the company vis-à-vis third parties in the legal form in question (limited/unlimited/no liability)?
   - Which corporate organs does each legal form have?

   How is the board or other managing organ of the company appointed in each of the legal forms? Who are the members of the board (its directors)? Is it possible to appoint a legal entity to be a member of the board of a company? On what grounds can members of a board be removed or withdrawn?
   - Is the board of the legal form in question bound to follow instructions of other corporate organs (eg shareholders' meeting or supervisory boards)?
   - Does the legal form in each case have a separate controlling/supervisory board? How is such a controlling/supervisory board of a company appointed and of whom or what does it consist? On what grounds can members of such supervisory boards be replaced?
3. Are there special requirements (eg education, professional skills) for persons to be appointed members of a board in each of the legal forms? If yes,

in what way is compliance with these requirements monitored and enforced?

4. What is the procedure where there is the possibility of misconduct on the part of the board? Is there provision for an external or other special audit or inquiry of the company to be carried out? Who may order such an audit? What kinds of resolutions/decisions are required in such case? May the possibility of an external audit or inquiry be limited by the company's articles of association or in any other relevant way?

II. Liability for Damage Caused to the Company and to the Shareholders

A. General requirements – scope of duties and violation of duty of care of directors

5. Under which general conditions can there be liability in the form of damages or compensation payable by directors or by the board itself? Is the liability of the director or board based on contract or tort or some other form of civil liability? Does the liability of the director or board differ from liabilities which arise under general principles of contractual or tortious liability? If yes, what are the nature of and rationale for these differences?
6. Beyond any special regulations laid down in the articles of association or otherwise agreed with an organ of the company, how are the general duties of the board and of its individual members described (please refer to both statute and case law)?
7. Is there a general duty to safeguard the interest of the company on the part of the board, and/or its members? Is the director's duty framed in terms of a general duty of care or in terms of a more specific duty or duties? Does the duty of care or other relevant duty extend beyond the performance of work-related tasks for the company to include aspects of the board member's personal or private life?

7.1. Case Study (safeguarding of interests): D is a director of the well-known C-Corporation.
   (a) A journalist takes a picture of D, heavily drunk, having an extra-marital affair.
   (b) A journalist takes a picture of D having a business meeting with a known member of the Mafia.

(c) It becomes public knowledge that D evaded paying a large amount of tax for his own benefit.

After these facts became public, other well-known companies terminate their business relation with C-Corporation. C-Corporation suffers pecuniary loss as a result. May D be held liable in damages? If yes, by whom?

7.2. Case Study (fiduciary duty and conflict of duties): D is a director of C-Corporation. C-Corporation holds a 50% share in A-Corporation. In his capacity as a director of C-Corporation, D is also a member of the supervisory board of A-Corporation. During a meeting of A-Corporation's supervisory board, D obtains knowledge of confidential information regarding the economic situation of A-Corporation; all members of the supervisory body of A-Corporation are obliged to observe secrecy thereof vis-à-vis third parties. Hence D does not inform C-Corporation of the economic situation of A-Corporation. C-Corporation suffers pecuniary loss as a result. May D be held liable in damages?

8. To what extent is the board under an obligation to exercise control or oversight (sometimes called 'internal control') over employees of the company, other organs of the company, or members of other such corporate organs? Which measures may or must be taken in order to secure compliance with this obligation?

9. Who is responsible in practice for complying with the duties set out above; in particular, is it the board as such, or is it individual directors?

9.1. Case Study: D1, D2 and D3 are directors of C-Corporation. In the board, a vote is taken to authorise a certain transaction to be made by C-Corporation; this transaction is foreseeably disadvantageous for C-Corporation. D1 and D2 vote in favour; D3 unsuccessfully tries to argue D1 and D2 out of their opinion and votes against authorising the transaction at the board meeting. As a result of the majority decision, the transaction is concluded and C-Corporation suffers pecuniary loss. Can D1, D2 and D3 each be held liable in damages in this case?

Alternative: D3 does not try to argue D1 and D2 out of their opinion, but merely votes against the transaction without giving reasons at the board meeting.

10. Which standard of care must be observed by a board and/or the individual directors when performing its/their duties? Is there a difference between the standard and/or content of these duties and those derived from general principles of tortious and contractual liability? If yes, what is the rationale or justification for these differences? To what extent does the law, when setting the relevant standard of care, take account of the need for the organ and/or member to exercise their judgement or discretion when exercising these duties?

10.1. Case Study (concretisation of the standard of duty; Business Judgment Rule): D is a director of C-Corporation. In order to remain competitive, C-Corporation must expand into other countries. Several countries present opportunities for expansion; however, it is possible, in each case, that the expansion will fail and that C-Corporation will suffer loss. Which measures or processes should D undertake or observe before he decides into which country C-Corporation should expand? Can D avoid liability for damages by not implementing the necessary expansion at all, due to the risks associated with it?

11. How far does the standard of care vary depending on the facts and circumstances of particular cases? Which factors influence the standard or content of the duty of care (eg the business focus of the company; the size of the company; the purpose of the company [in particular if it is a non-profit]; the financial scope of a given project; the financial situation of the company; the remuneration received by the directors; the expertise and training of directors; whether the director in question has an executive or non-executive function within the board)?

11.1. Case Study (applicable standard of care): D is a director of B-Bank. In this capacity he concludes a transaction in the name of B-Bank. From this transaction B-Bank suffers loss. For a person not involved in this field of business it was not apparent that it was an adverse transaction for B-Bank.

(a) A businessman or businesswoman familiar with this area of business, however, should have known that this particular concrete transaction would be adverse for B-Bank.

(b) A businessman or businesswoman familiar with this area of business could not have been expected to recognise this transaction as adverse. A more experienced professional manager, such as a manager of a bank, however, could have recognised this concrete transaction adverse for B-Bank.

May D be held liable in damages?

12. Are there special duties to which the board or one or more of the directors is subject in the case of insolvency (whether potential or actual)? Can a company suffering loss from breach of such duties be compensated for them? (Remark: the issue of losses suffered by creditors specifically is dealt with in question 24 below).

13. If directors may only be chosen from a certain group of people (eg only from the shareholders of the company, or only from persons with a certain level of professional training or qualification), does such a restriction affect the standard or content of the duty of care applicable to the board, or

to individual directors? May such a restriction be provided for in the articles of association?

14. Does the law provide for compensation to be paid where misconduct on the part of a director causes loss or damage to the corporation's property or to the shareholders'/partners' private property (including a decrease in the value of their shares)? Who may claim for such loss or damage?

14.1. Case Study: D is a director of C-Corporation. In this capacity he concludes a transaction with X in the name of C-Corporation. C-Corporation cannot meet its obligations in connection with this transaction; D should have foreseen this. C-Corporation must now pay damages of € 100,000 to the other contracting party. C-Corporation is owned by two shareholders, S1 and S2, each holding a share of 50%. Who may claim for damages resulting from D's misconduct?

Alternative: There are no claims for damages against C-Corporation as a consequence of a non-performance of the transaction which D concluded in the name of C-Corporation with X. However, the share value of C-Corporation falls after it became known that C-Corporation cannot meet its contractual obligations. Due to this misconduct there is a fall in the value of the shares held by S1 and S2. Can D be held liable for these losses?

14.2. Case Study (delay in filing for insolvency): D is a director of C-Corporation. C-Corporation is owned by two shareholders, S1 and S2, each holding a share of 50%. On 1 January the prerequisites for opening insolvency proceedings are met, as D should have known. However, D takes the necessary steps for opening insolvency proceedings only on 1 June. In the course of the insolvency proceedings, the entire property of C-Corporation is liquidated and distributed to the creditors (at the rate of 15% of their losses). Had D reacted immediately to the possibility of insolvency, all property of C-Corporation would have been liquidated; however, in this case, C-Corporation's liabilities would have been lower, and the creditors would have recovered at a higher rate (20%). Is it possible for the corporation or the shareholders (S1, S2) to file a claim for damages against D? (D's liability vis-à-vis the creditors of the company is discussed separately, see point 24 below).

15. Which statutes of limitation (that is, limitation of time) apply to claims for damages by the company and/or its shareholders against a director? Do these time periods differ from the general rules governing limitation of civil liability claims? If yes, what is the rationale or justification for this difference?

15.1. Case Study (suspension/interruption of the limitation period): D has been a director of C-corporation since 1990. In 1991 D caused damage to the

property of C-Corporation by authorising a negligently concluded transaction. Due to his position as a member of the board of C-Corporation, D was able to prevent his misconduct becoming known to shareholders of the company. Does this change anything with respect to the limitation of C's liability claims against D?

Alternative: Following misconduct he committed in 1991, D moved from the executive board to te supervisory board of C-Corporation. Due to his position on the supervisory board of C-Corporation, D was able to prevent his misconduct becoming known to members of the executive board and supervisory board, and to shareholders of the company. Does this change anything with respect to the limitation of D's liability?

B. Modification of the general conditions for liability

16. Is it possible to change the content and the scope of duties relating to a board and/or its members? If yes, in what way may such changes be made (eg articles of association; shareholders' resolution; contract of employment or other service contract of a director)?

16.1. Case Study (distribution of competences): D1 and D2 are directors of C-Corporation. In their respective contracts of employment (or other service contract) it is laid down that D1 is solely 'competent' for the business activities of C-Corporation on a national level, whereas D2 is solely 'competent' for the business activities of C-Corporation abroad. D2 concludes an apparently disadvantageous transaction for C-corporation in a foreign country. May D1 also be held liable for damages resulting from losses suffered by C-Corporation?

Alternative 1: D2 (who is 'competent' for the purposes of foreign business transactions) concludes an apparently disadvantageous national transaction, without the knowledge of D1. Who may be held liable for the loss C-Corporation suffered from this transaction?

Alternative 2: According to their respective contracts of employment or other service contract or terms of appointment, both D1 as well as D2 are 'competent' for all business activities of C-Corporation. However, it is agreed between D1 and D2 in a separate agreement (made under relevant rules of procedure for the conduct of the board) that D1 is solely 'competent' for the national business activities of C-Corporation, whereas D2 is solely 'competent' for business activities of C-Corporation abroad. May D1 be held liable for damage to C-Corporation caused by the foreign business transactions?

16.2. Case Study (authorisation of unlawful conduct): D is a director of C-Corporation. The main purpose of the company is, according to the articles of association of C-Corporation, to maximise its profits; for this purpose the board is also allowed, on the basis of the articles of association/shareholders' resolution/contracts of employment or other service contracts of directors:
(a) to violate rules regarding the maximum working hours of employees;
(b) to make side-payments to third parties to award contracts to C-Corporation, where this does not involve illegal behaviour on the part of those third parties;
(c) to pay bribes to third parties to award contracts to C-Corporation, giving rise to illegal behaviour on the part of those third parties;
(d) to place misleading or anti-competitive advertisements;
(e) to engage in illegal price-fixing with other companies;
(f) to trade with and in states which are subject to restrictive measures (such as an embargo) based on an EU Directive or another comparable national or supranational legal act.

Where, due to violations of laws arising from such conduct of the board and/or of individual directors, legal proceedings are opened against C-Corporation and, if applicable, a penalty is imposed on the corporation, may D be liable to pay damages in tort or otherwise face liability vis-à-vis the company or the shareholders (S1, S2) for the resulting losses (including legal costs, fines, etc)? Does this result change if authorisation to take the mentioned acts was not expressively given, but where the purpose of the corporation, the maximising of profits, was exclusively defined as the most important purpose of the company in the articles of association?

Alternative: Despite the authorisation stipulated in the articles of association/shareholders' resolution/contract of employment or other service contract or terms of appointment, D strictly observes all legal provisions. May D be held liable for reduced profits to either the company or its shareholders (S1, S2)?

17. May the standard set by the duty of care in relation to the board and its members be modified? If yes, in what way may such a change be made (eg articles of association; shareholders' resolution; contract between the company and the director)?

17.1. Case Study (reduction of due diligence standard): C-Corporation wants to appoint D to its board. D agrees on condition that his liability for possible misconduct vis-à-vis the corporation and the shareholders (a) is limited to gross negligence, (b) is limited to intentional harms, (c) is excluded for all types of fault. Can such agreements be effective? If yes, under what circumstances?

18. Is it possible to limit the liability of the board and/or its members in any other way? Is it possible to exclude it completely? If yes, how can this be done?

18.1. Case Study (other limitation of liability): C-Corporation wants to appoint D to its board. D only agrees under the condition that his liability for possible misconduct vis-à-vis the corporation and the shareholders
(a) is limited to damage other than pure economic loss;
(b) is limited to damages of an amount of more than € 100,000 (deductible);
(c) is limited to damages of an amount of no more than € 100,000 (liability cap);
(d) is limited to the amount which is covered by liability insurance taken out by D;
(e) is limited to personal injury;
(f) is limited to loss resulting from acts which can only be taken intentionally and which constitute a criminal offence;
(g) is completely excluded;
(h) may only be ascertained if the shareholders decide this by a majority vote of at least $^2/_3$ of the share capital.

Can such agreements be effective? If yes, under which conditions?

C. Authorisation and instructions by other organs of the company (in particular by the shareholders' meeting)

19. Under what circumstances are decisions of the board subject to authorisation by other organs of the company? Is this a matter which may be determined by the articles of association? Which organs of the company can be granted such powers of authorisation? If they exercise these powers, are they subject to a duty of care and if so what is its content?

19.1. Case Study (authorisation of an apparently disadvantageous transaction): D is a director of C-Corporation. It is stipulated by law (or by the articles of association) that a management decision intended to be taken by D is subject to authorisation by another organ of the company. D discloses to the competent corporate organ that this transaction is disadvantageous for the company; authorisation of the management decision applied for by D is nevertheless granted by the competent corporate organ. May D be held liable for the company's losses? May the organ of the company which authorised the decision be held liable in damages?

Alternative 1: D realises that the intended management decision is disadvantageous for the company. D, however, does not disclose this fact to the

corporate organ which is competent to authorise the transaction. As far as the corporate organ was concerned, the disadvantage was not apparent. After D obtained the authorisation for the disadvantageous management decision, he implemented it.

Alternative 2: D realises that the intended management decision is disadvantageous for the corporation, but does not disclose this to the corporate organ which is competent to make the authorisation. For the corporate organ in question, the disadvantage was not apparent, but it would have been apparent if due diligence had been taken. After D obtained the authorisation for the disadvantageous management decision, he implemented it.

20. May the board or individual directors be instructed to implement a certain management decision? If yes, under which circumstances and by which organs of the company? What are the consequences of such an instruction with respect to the liability of the board or director? May the organ of the company which made the instruction be held liable for the loss which the company suffered as a result of the implementation of such an instruction? If yes, under what circumstances is this the case?

20.1. Case Study (instructions regarding illegal/disadvantageous management decisions): D is a director of C-Corporation. The main purpose of the company as stipulated in the articles of association is maximising profits. For this purpose the board is instructed by the competent corporate organ (eg by shareholder resolution) or under the terms of a contract according to which the board has the power to use all means available to pursue the goals of the company:

(a) to violate rules regarding the maximum working hours of employees;
(b) to make side-payments to third parties to award contracts to C-Corporation, where this does not involve illegal behaviour on the part of those third parties;
(c) to pay bribes to third parties to award contracts to C-Corporation, giving rise to illegal behaviour on the part of those third parties;
(d) to place misleading or anti-competitive advertisements;
(e) to engage in illegal price-fixing with other companies;
(f) to trade with and in such states which are subject to restrictive measures (such as an embargo) based on an EU Directive or another comparable national or supranational legal act.

Where, due to violations of such provisions, legal proceedings are opened against C-Corporation and, if applicable, a penalty is imposed on the corporation, may D be liable to pay damages in tort or otherwise face liability vis-à-vis the company or the shareholders (A, B) for the resulting losses

(including legal costs, fines)? Is the organ of the company which gave the instruction, or its members, also liable?
Alternative: Despite the instruction, D observes all legal provisions. As a result, the profits of C-Corporation are lower. May D be held liable for the reduced profit at the suit of either the company or the shareholders (S1, S2)?

20.2. Case Study (distribution of profits): D is a director of C-Corporation. C-Corporation is owned by shareholders S1, S2 and S3, each holding a 1/3 share. In the shareholders' meeting a resolution to the effect that C-Corporation should distribute its full annual profit to the shareholders is passed with the votes of S1 and S2. As a result C-Corporation cannot replace obsolete machinery in the following business year. This leads to production downtimes and hence to a loss of profits. The fact that the acquisition of new machinery was necessary but only feasible if profits were retained was foreseeable by D as well as by shareholders S1, S2 and S3 at the time the resolution was passed. Can D be held liable by the company or one of the shareholders? Is it possible to hold individual shareholders liable? Would D have had the power or duty, under company law, to prevent such a distribution?

20.3. Case Study (covert return of contributions): D is a director of C-Corporation. C-Corporation is owned by shareholders S1, S2 and S3, each holding a 1/3 share. In the shareholders' meeting a resolution that C-Corporation should buy real estate owned by S1 for an amount of € 2 million is passed with the votes of S1 and S2. The actual value of the property is only € 1 million, a fact that shareholders (S1, S2 and S3) as well as D know. D concludes the purchase contract in the name of C-Corporation. Can D be held liable to the C-Corporation or to one or more of the shareholders? Is it possible to hold the shareholders' meeting or individual shareholders liable? Are there ways by which C-Corporation could avoid the disadvantageous transaction, for example by annulling it?
Alternative 1: C-Corporation is owned by shareholders S1, S2 and S3, each holding a 1/3 share. S1 requests D to buy real estate owned by S1 for the amount of € 2 million in the name of C-Corporation; otherwise, S1 will make sure that D's appointment to the board of C-Corporation is not extended. The actual value of the property is only € 1 million, a fact known to both S1 as well as D. D concludes the purchase contract in the name of C-Corporation. Is it possible to hold D liable vis-à-vis C-Corporation or one of the shareholders? Is it possible to hold individual shareholders liable? Are there ways by which C-Corporation could avoid the disadvantageous transaction, for example by annulling it?

Alternative 2: D is a director of C-Corporation. The owners of C-Corporation are D with a share of $^2/_3$ and S, holding a share of $^1/_3$. In the shareholders' meeting a resolution that C-Corporation should buy real estate owned by D's spouse for the amount of € 2 million is passed with the votes of D. The actual value of the property is only € 1 million, a fact known to both S and D. The value of S's shareholding is reduced by this transaction. May D be liable in damages in tort or some other form of civil liability to the company or the other shareholder (S)? Are there ways by which C-Corporation could avert the disadvantageous transaction, for example by annulling it?

20.4. Case Study (covert return of contributions within a group of companies): D is a director of C-Corporation. 100% of the shares in C-Corporation are owned by M-Corporation. M-Corporation is also the sole shareholder in A-Corporation (an affiliated company of C-Corporation) which is facing economic troubles. M-Corporation passes a resolution, as sole shareholder of C-Corporation, to the effect that C-Corporation should grant A-Corporation an interest-free loan in the amount of € 1 million so that A-Corporation can be saved from insolvency. A-Corporation is no longer able to provide collateral and would not be able to take out a loan from a third party; this was known to D. May D be liable in damages in tort or some other form of civil liability vis-à-vis the company or the shareholder? May M-Corporation as shareholder become liable in damages in tort or some other form of liability to C-Corporation? Are there ways by which C-Corporation could avert the disadvantageous transaction, for example by annulling it?
Alternative 1: The shareholders of C-Corporation are M-Corporation, holding a share of 90%, and N, holding a share of 10%. M-Corporation as 90% shareholder of C-Corporation passes a resolution that C-Corporation should grant A-Corporation an interest-free loan in the amount of € 1 million so that A-Corporation can be saved from insolvency. Does this change the assessment in any way?
Alternative 2: Only shortly after the loan is paid out, A-Corporation becomes insolvent. This was foreseeable both for M-Corporation as well as for D at the time the decision regarding the granting of the loan was taken. Does this change the assessment in any way?

D. Waiver of and agreement regarding indemnity

21. May the company waive its right to claim for damages in tort or some other form of civil liability against the board of or one of the directors? If so, under what circumstances is such a waiver legally effective? Which organ of

the company has the right to represent the company in connection with such an agreement?

21.1. Case Study: D is a director of C-Corporation, which is 100% state-owned. D is concerned about a change in the political leadership of the ministry responsible for C-Corporation in the near future. In order to guard against possible claims for damages following the political change, the company and the representative of the shareholder agree a waiver that
   (a) includes all possibly already incurred claims against D,
   (b) includes all possibly already incurred claims against D due to minor acts of negligence.

   At the time the waiver is agreed there is no indication that any claims against D exist. Under what circumstances is such waiver feasible and effective? Which organ of the company can declare such a waiver in the name of the company?

   Alternative: Does it change the assessment if at the time the waiver is made it is already foreseeable that the company and/or the shareholder would have a right to claim for damages in tort or some other form of civil liability against D?

22. May the corporation undertake to indemnify the board or and/or individual directors (indemnity agreement) in the event that the board and/or individual directors are prosecuted for acts undertaken on the company's behalf or sued for damages by third parties? If yes, under what circumstances and to what extent would such indemnification be feasible? Could a compensation payment to a director be provided for in a case where the director concerned was sentenced to a term of imprisonment? Which organ of the company has the right to represent the corporation in connection with such agreement?

22.1. Case Study: D is a director of C-Corporation. C-Corporation tells D that the company will pay any amount which he is or becomes legally obligated to pay by virtue of any claim made against him relating to any act or omission or breach of duty which he commits while acting in his capacity as a director and officer of C-Corporation. The payments which C-Corporation is obligated to make include payments by way of damages, judgments, and settlements, as well as costs of defence of legal actions, claims or proceedings and appeals therefrom.
   (a) D is sentenced to pay a fine for an offence of speeding which he committed on his way home from a board meeting.
   (b) D is sentenced to pay a fine for falsification of the company's balance sheet.
   (c) D is sued by P, a competitor of C-Corporation, because he made false statements about a lack of quality of P's products in a newspaper

interview. P succeeds with his action and D is found liable in damages.

(d) D is sued for damages for sexual harassment by a co-worker and ordered to pay compensation. In addition D is prosecuted and sentenced to pay a fine.

Is C-Corporation obliged to compensate D in these cases for the costs of legal representation, court fees, the fines which are imposed, and the compensation which is payable?

III. Liability for Damage to Third Parties

23. Under what circumstances is the board liable for damage caused to third parties in connection with activities carried out on behalf of the company?

23.1. Case Study (instruction to inappropriate advice by sales representatives): D is a director of C-Corporation. The products of C-Corporation are distributed by C-Corporation's employees. D instructs these employees to provide inappropriate information to possible purchasers, if necessary, and to give incomplete advice in order to sell as many products as possible. Due to inappropriate advice given by a sales representative of C-Corporation:
(a) P purchases a worthless product,
(b) P suffers physical injury when using the product.
C-Corporation becomes insolvent. May P sue D for damages?
Alternative: D directly participates in the sales. Does this change the legal assessment?

23.2. Case Study (false annual statement): D is a director of C-Corporation. C-Corporation is in search of investors. In negotiations with an interested party P, D presents
(a) negligently
(b) intentionally
false balance sheets. P then invests in C-Corporation. C-Corporation becomes insolvent, which would have been foreseeable to P if the correct balance sheets had been presented. May P sue D for damages?
Alternative: D1 and D2 are directors of C-Corporation. D1 does not present P with false balance sheets himself, but persuades D2 to do so. May P sue D1 and D2?

23.3. Case Study (incorrect prospectus): D is a director of C-Corporation. C-Corporation issues listed securities. For this purpose a prospectus is published which is based on the most recent annual accounts. D

(a) negligently
(b) intentionally

provides incorrect information about the company's situation to the auditor. P invests in C-Corporation's securities. C-Corporation becomes insolvent. May P sue D for damages?

23.4. Case Study (violation of cartel law): D is a director of C-Corporation. D participates in illegal price-fixing with other companies in the name of C-Corporation. P suffers pecuniary loss therefrom. May P sue D for damages?

23.5. Case Study (infringement of competition law): D is appointed a director of C-Corporation. D authorises misleading advertisements in which incorrect information about the products of the competitor P is given. As a result P suffers pecuniary loss. May P sue D for damages?

24. May the board and/or individual directors be held liable to the company's creditors in the event of the corporation's insolvency? If yes, under what circumstances and to what extent does such liability exist?

24.1. Case Study: D is a director of C-Corporation. On 1 January 2014 the prerequisites for opening insolvency proceedings are met, as D should have known. However, D takes the necessary steps for the opening of insolvency proceedings only on 1 June 2014. In the course of the insolvency proceedings the entire property of C-Corporation is liquidated, the proceeds are distributed to the creditors (at a rate of 15% of their claims) and C-Corporation is then liquidated. Had D reacted immediately, all property of C-Corporation would have been liquidated, too; however, in this case, C-Corporation's liabilities would have been lower and the creditors would have recovered at a higher rate (20%) in the course of the distribution of the company's property.

(a) P1 granted a loan in the amount of € 1 million to C-Corporation on 1 December 2013.
(b) P2 granted a loan in the amount of € 1 million to C-Corporation on 1 March 2014.
(c) P3 concluded an agreement regarding the sale of goods with C-Corporation on 1 May 2014, the purchase price (€ 1,000) which was payable upon delivery of the goods. C-Corporation is no longer able or willing to perform this contract, and the contract is annulled. If P3 had known that C-Corporation had already become insolvent at the time the contract was concluded, he would have sold his goods at the price of € 900 to X. This is no longer feasible with the result that P3 must sell to Y at a price of € 500.

May P1, P2 and P3 sue D for damages? If yes, to what extent?

25. May the board and/or individual directors be made liable for breach of other duties owed by the company to its creditors? If yes, under what circumstances, and to what extent does such liability exist?

25.1. Case Study: D is a director of C-Corporation. According to law, C-Corporation is obliged to publish annual financial statements within a certain time after the business year has ended. D fails to publish the annual statement in a timely way and in the required form. P concludes a contract with C-Corporation which C-Corporation is not able to perform, because the company becomes insolvent before the time for performance is due. If the annual accounts had been published in time, P would have been able to see that the intended transaction was beyond the economic capacity of C-Corporation. P has already provided services in advance to C-Corporation which will not now be paid for. May P sue D?

26. If a third party suffers damage as a consequence of the board breaching its duty to the company, is it possible to hold the board directly liable vis-à-vis creditors of the corporation? If yes, under what circumstances and to what extent does such liability exist?

27. Is it possible to limit the liability of the board or managing organ and/or individual directors to third parties by the company granting the board or its members a limitation on liability (under eg the articles of association, a shareholders' resolution, or the contract of employment or other service contract of a board member)?

27.1. Case Study (limitation of liability): C-Corporation wants to appoint D to its board. D agrees on condition that his liability for possible misconduct vis-à-vis the company and the shareholders

(a) is limited to gross negligence;
(b) is limited to damages caused intentionally;
(c) is excluded for any fault;
(d) is limited to liability for damage not amounting to pure economic loss;
(e) is limited to damages of an amount of more than € 100,000 (deductible);
(f) is limited to damages of an amount of no more than € 100,000 (liability cap);
(g) is limited to the amount which is covered by liability insurance taken out by D;
(h) is limited to liability for personal injury;
(i) is limited to damages resulting from acts which can only be taken intentionally and which constitute a criminal offence.

Can D's liability vis-à-vis third parties be limited or excluded under the articles of association, a shareholders' resolution, or the contract of em-

ployment or other service contract of a board member? What effect would such agreements have on D's liability vis-à-vis the company?

IV. Procedural Law Aspects

28. Which of the following persons and corporate organs can be parties to a suit for damages due to the misconduct of a board pursuant to your national procedural law? (If your national corporate law provides for more corporate organs or persons to sue, please complete the question accordingly.)
    (a) an individual director;
    (b) the whole board, even where it consists of several directors;
    (c) the individual members of the supervisory board;
    (d) the whole supervisory board, even where it consists of several members;
    (e) the individual shareholders;
    (f) the shareholders' meeting, even where it consists of several members;
    (g) committees of all corporate organs, even where they consist of several members.
29. Who represents the company in a suit for damages against the board and/or one or more of its directors? Are special requirements needed (eg resolution of the shareholders' meeting) for such a suit to proceed? What is the effect on litigation of such a requirement not being met?
30. Is it possible for a lawyer who represented the company and worked closely with its board in the past to represent the company in a suit for damages against the board? Is such a lawyer allowed to represent the board in a suit against the company?
31. Are there special procedural rules for claims for damages against boards and/or their members? Which court is competent to hear these legal disputes?

V. Insurance Law Aspects

32. In your national law, are there general rules – whether statutory or case law – relating to D&O insurance? Is D&O insurance regulated in a Corporate Governance Code, where such a Code exists? What do the rules regarding D&O insurance include? Are deductibles obligatory? If yes, under what circumstances? Is it possible for a director or officer to take out extra insurance cover for bearing the deductible?

33. Which persons are party to the insurance agreement of the D&O insurance? Who is obliged to pay the insurance premiums relating to the D&O insurance (policyholder)? If the company makes the premium payments, are these payments deductible from the remuneration of the members of the managing or executive board? If the company is the contractual counterparty of the insurer, who is authorised to represent the company in concluding the insurance contract?
34. Who is the insured person? Is it possible to insure a group of persons (eg all members of a corporate body and/or all senior employees of a company) against a defined risk in one comprehensive insurance contract (group insurance)? Is it possible to insure members of a corporate body and senior employees of a subsidiary or an affiliate company (outside directors)?
35. Who has the right to claim for performance under a policy in a case where the insurance contingency has occurred? May third parties assert direct claims against the insurer?

35.1. Case Study (claims for performance by the company): D is a director of C-Corporation. In respect of liability of D resulting from his activities for C-Corporation, there is insurance cover provided by I-Insurance in the form of a D&O insurance policy. As a consequence of misconduct in connection with his activities as a director, D becomes liable to C-Corporation. The D&O insurance covers this liability. May C-Corporation assert directly the claim for performance under the policy?
Alternative 1: D goes into hiding. Does this change the legal assessment?
Alternative 2: D becomes bankrupt. Does this change the legal assessment?

35.2. Case Study (claims for performance by third parties): D is a director of C-Corporation. In respect of liability of D resulting from his activities for C-Corporation, there is insurance cover provided by I-Insurance in the form of a D&O insurance policy. As a consequence of misconduct in connection with his activities as a director, D becomes liable to P (a contractual counterparty of C-Corporation). May P assert directly the claim for performance under the policy?
Alternative 1: P has no contractual relationship with C-Corporation. Does this change the legal assessment?
Alternative 2: D becomes bankrupt. Does this change the legal assessment?

36. How is the event insured against usually defined in the terms of the D&O insurance policy? Does an insured event occur when the company receives a claim letter from a shareholder or third party? In what way does the D&O insurance policy differ from legal protection insurance in this respect?

36.1. Case Study (costs of defending a director against a claim by the company): D is a director of C-Corporation. In respect of liability of D resulting from his activities for C-Corporation, there is insurance cover provided by I-Insurance in the form of a D&O insurance policy; the insurance premiums are paid by C-Corporation. C-Corporation claims to have suffered pecuniary loss due to D's misconduct and asserts its claims. D denies the claims of C-Corporation and engages in the lawsuit. Are the costs of the defence against asserted claims of C-Corporation, which pays the insurance premiums as the policyholder, included in the coverage provided by a typical D&O insurance policy?

37. Which benefits does an insurer usually have to perform under a D&O policy (eg coverage of costs for legal defence; release from claims of the company and from claims of third parties; investigation costs)? Please state in particular whether the following insurance agreements are common in your jurisdiction:
    (a) Direct Coverage: direct indemnification of the directors and officers for acts for which the corporate organisation is not legally required to indemnify the directors and officers.
    (b) Corporate Reimbursement: coverage of the corporation for amounts it pays out due to an indemnification agreement on behalf of its directors and officers for defence costs, settlement amounts or judgments.
    (c) Securities Entity Coverage: coverage of the corporation for securities claims brought against it.

    Is an insurer also obliged to grant advance payments, even if it is not yet clear whether there is actually cover, according to general policy conditions? May there be an obligation of the insurer to appoint counsel, develop and implement defence strategy, and generally take care of a claim against an insured (duty to defend)? May the right of the individual insured person to choose his own lawyer be limited? In what way does D&O insurance differ from legal protection insurance in this respect?

37.1. Case Study (advance payments for legal defence): D is a director of C-Corporation.
    (a) C-Corporation sues D for damages due to alleged breach of duty.
    (b) A contractual counterparty of C-Corporation sues D for damages due to alleged breach of duty.
    (c) D is prosecuted for a crime.

    D denies the breach of duty he is accused of and engages in the lawsuit. Does this constitute an insured event according to the typical conditions of a D&O insurance policy? Does D have the right to be paid compensation for the costs of his legal representation in this lawsuit, according to the ty-

pical conditions of a D&O insurance policy? Is an insurer obliged to cover D's costs before the lawsuit is finally terminated?

37.2. Case Study (fines and imprisonment): D is a director of C-Corporation. D is prosecuted and sentenced
(a) to pay a conditional/unconditional fine;
(b) to conditional/unconditional imprisonment
for
(a) intentionally committing
(b) negligently committing
an offence against property which he committed when performing his activities as a director. Which payments may D claim in connection with the D&O insurance?

37.3. Case Study (pure economic loss/mass claims): D is a director of C-Corporation. D negligently provided the annual auditor with incorrect information about the corporation's situation. As a result, incorrect annual statements are published. Many investors rely on the correctness of the annual statement and buy securities of C-Corporation. C-Corporation becomes insolvent, which would have been foreseeable if the annual statements had been correct. May the investors sue D for damages? Assuming the information was an opinion, may a plaintiff plead that a statement of opinion was 'untrue' merely by alleging that the opinion itself was objectively wrong, or must the plaintiff also allege that the statement was subjectively false? Which liabilities or payments may D assert in connection with the D&O insurance?

38. Which duties and obligations of a policyholder and an insured person are stated in typical general policy conditions? When are a policyholder and an insured person obliged to give notification of the insured event to the insurer (eg when a claim is asserted; when an official request is made; when a claim is alleged)? To what extent may there be an insurer's right of participation in the claims handling process (eg in developing defence strategy and settlement negotiations)? What is the consequence of a breach of these duties/obligations?

39. What is typically excluded from insurance coverage in general policy conditions? Is there typically an exclusion for deliberate or conscious breaches of duty (often phrased as 'any deliberately fraudulent, dishonest or criminal act or any wilful violation of any civil or criminal statute, regulation or law')? Would it be considered to be against the law (eg on grounds of 'public policy') to insure such intentional acts? Would it make a difference if civil or criminal law sanctions attached to such wrongful acts?

40. In a case where the insurance company refuses cover, who may file a claim for determining the coverage of the insurance (insurance coverage declaratory-judgment litigation)? Is it possible to define the insurance agreement in such way that an action for insurance coverage declaratory-judgment can be filed by the company (policyholder) so that the insured person (the director) does not need to file such a claim?
41. What are the differences between the legal position of the board or director in the following two situations?

41.1 Case Study (comparison of D&O insurance vs exclusion of liability): D is a director of C-Corporation.

(a) C-Corporation purchases a D&O insurance policy for the benefit of D at its own expense, covering all claims for damages by the company against D on grounds of negligent breach of duty.
(b) In D's contract of employment or conditions of appointment, C-Corporation declares that liability of D to the company for negligent breach of duty is excluded.

Country Reports

M Karollus and K Riedler

Directors' and Officers' Liability in Austria

I. General Part – Overview of the Corporate Law Framework

1. Nature of and distinction between various types of companies

Austrian law provides for the following legal forms of a company:[1] **1** *Aktiengesellschaft* (stock corporation),[2] *Europäische Gesellschaft* (Societas Europaea = European Company),[3] *Gesellschaft mit beschränkter Haftung* (limited liability company),[4] *Genossenschaft* (registered co-operative society),[5] *Europäische Genossenschaft* (Societas Cooperativa Europaea = European Co-operative),[6] *Sparkasse* (savings bank),[7] *Versicherungsverein auf Gegenseitigkeit* (mutual insurance company),[8] *Verein* (registered association),[9] *Privatstiftung* (private foundation),[10] *gemeinnützige Stiftung* (charitable founda-

1 Furthermore, an enterprise may be operated by an individual natural person (*Einzelunternehmer*, sole proprietor). In practice, this legal form is only relevant for (very) small enterprises.

2 The legal basis is the Austrian Stock Corporation Act (*Aktiengesetz*, AktG).

3 This legal form is primarily based on the European Union Regulation on European Companies. In addition, for a Societas Europaea with its seat in Austria, the Austrian supplementary statute on SEs (*SE-Gesetz*, SEG) and the Austrian Stock Corporation Act are applicable.

4 The legal basis is the Austrian Limited Liability Companies Act (*Gesetz über Gesellschaften mit beschränkter Haftung*, GmbHG).

5 The legal basis is the Austrian Co-operatives Act (*Genossenschaftsgesetz*, GenG).

6 This legal form is primarily based on the European Union Regulation on European Co-operatives. In addition, for a European Co-operative with its seat in Austria, the Austrian supplementary statute on European Co-operatives (*SCE-Gesetz*, SCEG) and the Austrian Co-operatives Act are applicable.

7 The legal basis is the Austrian Savings Banks Act (*Sparkassengesetz*, SpkG).

8 For the legal basis, see §§ 35–81 of the Austrian Insurance Supervision Act (*Versicherungsaufsichtsgesetz 2016*, VAG 2016).

9 The legal basis is the Austrian Registered Associations Act (*Vereinsgesetz*, VerG). Under Austrian law, a registered association must pursue a non-material purpose and is therefore restricted in operating an enterprise. Nevertheless, even some big enterprises are operated by registered associations.

10 The legal basis is the Austrian Private Foundations Act (*Privatstiftungsgesetz*, PSG). An Austrian private foundation is strictly restricted in operating an enterprise, this being allowed only as a secondary aim. On the other hand, many private foundations hold significant stakes in

tion),[11] *Offene Gesellschaft* (general partnership),[12] *Kommanditgesellschaft* (limited partnership),[13] *Europäische Wirtschaftliche Interessenvereinigung* (European Economic Interest Grouping = EEIG)[14] and *Gesellschaft bürgerlichen Rechts* (civil law association).[15] Furthermore, enterprises may be directly operated by public bodies (*Eigenbetriebe von Körperschaften des öffentlichen Rechts*).

2 Under Austrian law, there is a *numerus clausus* of legal forms. Therefore, no further legal forms may be created. However, within the existing legal forms there is more or less room for individual design, and for mixing up different legal forms. One important example of the latter is a limited partnership with a limited liability company as the only general partner (*GmbH & Co KG*), thus meaning that the only partner with full liability is an entity with limited liability.[16] Furthermore, according to the case law of the European Court of Justice,[17] European Union law (the freedom of establishment) grants the right that all legal forms founded under the law of member states of the EU and the EEA may

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corporations and/or hold very valuable assets. The potential liability of the directors of a private foundation is taken very seriously, and there is a significant demand for D&O insurance.

11 The legal basis is the Austrian Charitable Foundations and Funds Act (*Bundes-Stiftungs- und Fondsgesetz 2015,* BStFG 2015).

12 For the legal basis, see §§ 105–160 of the Austrian Enterprise Code (*Unternehmensgesetzbuch,* UGB).

13 For the legal basis, see §§ 161–178 UGB.

14 This legal form is primarily based on the European Union Regulation on European Economic Interest Groupings. In addition, for a European Economic Interest Grouping seated in Austria, the Austrian supplementary statute on EEIGs (*EWIV-Gesetz,* EWIVG*)* and the Austrian provisions for general partnerships are applicable.

15 For the legal basis, see §§ 1175–1216e of the Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch,* ABGB).

16 In this case, both the legislator and case law have imposed special rules governing such a 'hybrid' company. The main aim of these rules is that such a company shall be treated similarly to a limited liability company, based on the conclusion that, from the perspective of the creditors, there is no relevant difference to a limited liability company. So for example, accounting is to be performed in the same way as for a stock corporation or a limited liability company (§§ 189(1) no 2, 221(5) and 224(3) UGB), a petition for insolvency is also obligatory in cases of overindebtedness (§ 67(1) of the Austrian Insolvency Code – *Insolvenzordnung*, IO), and the legal provisions on equity substitution (*Eigenkapitalersatz*) are applicable to such companies (§ 4 no 3 of the Austrian Equity Substitution Act – *Eigenkapitalersatz-Gesetz,* EKEG). Furthermore, according to the case law of the Austrian Supreme Court (*Oberster Gerichtshof*, OGH), the prohibition of repayments (*Einlagenrückgewähr*) is applied by analogy to such companies (OGH 29.5.2008, 2 Ob 225/07p; 23.2.2016, 6 Ob 171/15p; 30.8.2016, 6 Ob 198/15h).

17 See particularly the judgments in the cases CJEU 9.3.1999, C-212/97, *Centros v Erhvervs- og Selskabsstyrelsen*, ECLI:EU:C:1999:126, 5.11.2002, C-208/00, *Überseering v NCC*, ECLI:EU:C:2002:632 and 30.9.2003, C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art*, ECLI:EU:C:2003:512.

also be used in Austria, even for solely domestic activities. Some Austrian enterprises have made use of these possibilities, eg by being incorporated in the legal form of a Private Company Limited by Shares under English law. In such cases, tricky issues of applicable law may arise: it is decisive, for example, whether the duties to file for insolvency or not to make payments in the state of insolvency are attributed to corporate law or to insolvency law; in the latter case, the applicable law would be determined by the EU Insolvency Regulation,[18] resulting in the *lex fori concursus* as the relevant point of reference.[19]

3 Not every legal form is allowed for every *business purpose*. For example, banks are only allowed to operate in the legal forms of a stock corporation (including the European Company), a co-operative society (including the European Co-operative) or a savings bank, and for insurance companies it is not possible to operate in any other legal forms than those of a stock corporation (European Company) or a mutual insurance company. In general, a civil law association is allowed only for 'minor' enterprises,[20] whereas major enterprises are to be operated in other legal forms. EEIGs are restricted to cooperation purposes between enterprises seated in at least two different EU or EEA member states.[21]

4 Under Austrian law, *public companies* in the sense that the shares may be publicly issued and traded must have the legal form of a stock corporation (or of a European Company). The Austrian Stock Corporation Act applies both to public and private companies. However, there are some distinctions drawn in this statute, which have increased significantly during the last decades: some provisions apply only to public companies (*börsenotierte Gesellschaften*[22]), and some only to private companies. For example, bearer shares are only allowed for public companies,[23] in public companies further possibilities for a repurchase of shares are granted,[24] the legal rules regarding the shareholders' meeting differ significantly,[25] and individual rights to nominate members of the supervisory board are more restricted in public companies.[26] Furthermore, public

18 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (2015) Official Journal (OJ) L 141/19.

19 On this, see CJEU, 10.12.2015, C-594/14, *Kornhaas v Thomas Dithmar*, ECLI:EU:C:2015:806.

20 On this, see § 8(3) UGB in connection with § 189 of said statute.

21 For this, see arts 3 and 4 of the EEIG Regulation.

22 For a definition, see § 3 AktG.

23 See § 10 AktG.

24 See § 65 AktG.

25 See eg §§ 111 and 112 AktG.

26 See § 88(1) AktG.

companies are also governed by specific statutes in the field of Capital Markets Law.[27]

5 In general, the substance of the *directors' duties does not differ* between private and public companies. For example, in both cases the directors are obliged to act in the best interest of the company (see below no 28). However, only directors of a public company are required to fulfil the duties imposed by Capital Markets Law, eg the specific disclosure duties or the duty to refrain from insider dealings. Such duties may also be relevant for companies whose shares are not listed if other securities, eg bonds or profit participation rights, are traded publicly.

2. Legal personality and its consequences and the appointment, removal and accountability of the board

6 Under Austrian law, stock corporations, European Companies, limited liability companies, registered co-operative societies, European Co-operatives, savings banks, mutuals and registered associations possess *legal personality* (*Rechtspersönlichkeit*). General partnerships, limited partnerships and EEIGs do not possess legal personality, but nevertheless they possess legal capacity, ie the ability to obtain rights and obligations (*Rechtsfähigkeit*). A civil law association does not even possess legal capacity, which means that the rights and obligations are allocated to its members, and only its members are parties to a contract.

7 A *separation of the company's property* from the shareholders'/partners' property is established for all legal forms which possess legal personality, or at least legal capacity in the sense mentioned before. As for the civil law association, the property dedicated to the association is legally construed being in common ownership of the associates.

8 Shareholders of a stock corporation, a European Company, a limited liability company, a registered co-operative (in the usual form of a co-operative with limited liability),[28] a European Co-operative or a registered association are *not*

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27 Especially the Austrian Securities Exchange Act (*Börsegesetz*, BörseG), and the relevant European Regulations.

28 Under Austrian law, three types of registered co-operatives are possible. One type is a co-operative with unlimited liability (*Genossenschaft mit unbeschränkter Haftung*). However, for understandable reasons this type of co-operative is not common at all. As for the co-operative with limited liability, which is by far the most common, the shareholders are not liable towards the co-operative's creditors, but they are obliged to make certain contributions in the case of insolvency. The third type of a co-operative without any liability (*Genossenschaft mit*

liable for debts of the company.[29] On the other hand, partners of a general partnership, an EEIG and associates of a civil law association are liable for all debts of the company.[30] In the case of the limited partnership, at least one partner (*Komplementär* = general partner) is liable for all debts without limits, whereas the liability of the other partner(s) (*Kommanditist* = partner liable up to a fixed amount) is limited with a certain amount as agreed on in the articles of association and published in the company register (*Firmenbuch*).[31]

9 For a stock corporation, the following *organs* are required: board of directors (*Vorstand),* supervisory board (*Aufsichtsrat*), shareholders' meeting (*Hauptversammlung*) and auditor (*Abschlussprüfer*). For a European Company, either the same system (dualistic system) or a monocratic system, with only one administrative body (*Verwaltungsrat* = management board) instead of the board of directors and the supervisory board may be established. For a limited liability company, directors (*Geschäftsführer*) and the shareholders' meeting (*Generalversammlung*) are mandatory in any case; a supervisory board and an auditor are required only under specific circumstances, depending for example on the scale of the company or the number of employees. For a registered co-operative, a board of directors (*Vorstand*), a shareholders' meeting (*Generalversammlung*) and an auditor (*Genossenschaftsrevisor*) are required in all cases, and for co-operatives with at least 40 employees also a supervisory board (*Aufsichtsrat*). Savings banks need a board of directors (*Vorstand*), and a specific body called *Sparkassenrat* which can be compared to a supervisory board. For mutuals, a board of directors (*Vorstand*), a supervisory board (*Aufsichtsrat*) and a members' meeting (*Mitgliederversammlung*) are required. A registered association needs to have a management (*Leitungsorgan*), a members' meeting (*Mitgliederversammlung*), controllers (*Rechnungsprüfer*), and in some cases also a supervisory board (*Aufsichtsrat*) and an auditor (*Abschlussprüfer*). An EEIG at least requires directors (*Geschäftsführer*) and the collectively acting members (*gemeinsam handelnde Mitglieder*). In general partnerships, limited partnerships and civil law associations, the partners/the associates, or some of them act as organs.

10 In the following, only the stock corporation and the limited liability company, as the *most important legal forms* in Austria, shall be described:

Geschäftsanteilshaftung) is restricted to specific purposes and therefore not very common, either.

29 However, in specific cases such a liability could apply, see eg § 56(1) AktG. Furthermore, under certain circumstances the shareholders may be liable for damages.

30 See § 128 UGB, art 24 of the EEIG Regulation and § 1199 ABGB.

31 See § 171 UGB.

11 The *director* or the members of the board of directors, if there is more than one director,[32] are *appointed* by the supervisory board (in the case of the stock corporation)[33] or by the shareholders (in the case of the limited liability company).[34]

12 The appointment may be *revoked* by the same organs.[35] In a stock corporation, where the directors are appointed for a certain period (5 years maximum), a premature revocation is allowed only for good cause; if the shareholders' meeting passes a resolution declaring a lack of confidence in a director, this is deemed to be a sufficient cause. In a limited liability company, the revocation is possible irrespective of the reasons, unless the articles of association state otherwise. Individual shareholders may demand the removal of a director by the court if they can prove that there is good cause for such a removal.

13 The members of the *supervisory board are appointed* (elected) by the shareholders or, as far as minority rights or specific rights of appointment are concerned, by some of them. Subsidiarily, members as it were missing from the board may be appointed by the competent court.[36] In addition, further members (one member for each two appointed by shareholders, and another member in case of an uneven number appointed by the shareholders) may be appointed by the Works Council.[37]

14 If members of the supervisory board were elected by the shareholders, the shareholders' meeting may *revoke* the appointment. The same applies to individual shareholders with respect to the members any individual shareholder has appointed in pursuance of a right to appoint supervisory board members, granted in the articles of association. Regardless of how such has been appointed, the competent court may always dismiss a supervisory board member for good cause. Members that were appointed by the Works Council can only be recalled by this council. Neither a revocation of the appointment by shareholders nor by the court is possible.

15 *Legal entities* are not allowed to be a director or a member of the supervisory board in a stock corporation or in a limited liability company.[38] On the other hand, legal entities may be shareholders of such a company, and they are allowed to be auditors.

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32 This is only required for certain fields of business, eg for banks and insurance companies.

33 See § 75 AktG.

34 See § 15 GmbHG.

35 See § 75(4) AktG and § 16 GmbHG.

36 See §§ 87–89 AktG and §§ 30b–30d GmbHG.

37 See § 110 of the Austrian Works Council Constitution Act *(Arbeitsverfassungsgesetz,* ArbVG*)*.

38 See §§ 75(2) and 86(1) AktG; §§ 15(1) 2nd sent and 30a(1) GmbHG.

3. The qualifications of board members

16 In general, there are no formal requirements regarding the qualifications of board members. However, according to established case law, members of an administrative body are deemed to have some minimum abilities,[39] meaning that it is impossible for them to avoid liability by stating that due to a lack of these abilities, the organ was not able to act in another way, for example to recognize certain risks (see also below nos 50 and 51).

17 Persons who are to be elected onto the *supervisory board* are obliged to give an overview of their fields of expertise and professional experience to the shareholders' meeting.[40] Based on this information, it is up to the shareholders to decide whether they want to elect said person. Furthermore, for stock corporations there are general provisions stating that aspects of diversity shall be taken into account for the composition of the supervisory board.[41] Moreover, in public companies, as well as stock corporations and limited liability companies with permanently more than 1,000 employees, under certain circumstances the supervisory board must consist of at least 30% female and at least 30% male members (see § 86(7)–(9) AktG and § 30 3rd sent GmbHG, as amended by BGBl I 2017/104).

18 *Specific requirements* for such organs are mandatory in certain areas, eg for organs of a bank or of an insurance company (so-called 'fit and proper test'); in these cases compliance is monitored and enforced by the Austrian Financial Market Authority.[42]

4. Investigations into directors' misconduct

19 In the case of possible misconduct on the part of the *board* (the directors), the other members of the board are obliged to investigate whether there was or is misconduct, and, in the affirmative, to take all necessary steps to stop the misconduct. Furthermore, the *supervisory board* is obliged to do the same, in the case of a stock corporation the relevant steps include the possibility to revoke the appointment of directors.[43] In a limited liability company, the shareholders are competent for the revocation of the appointment of a director; thus, the su-

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39 For members of the supervisory board, see OGH 26.2.2002, 1 Ob 144/01k.

40 See § 87(2) AktG and § 30a(1) GmbHG.

41 See § 86(7)–(9) AktG, § 30 3rd sent GmbHG, as amended by BGBl I 2017/104, and § 87(2a) AktG. There is no similar provision in the Austrian Limited Liability Companies Act.

42 In German: *Finanzmarktaufsicht*.

43 § 75(4) AktG.

pervisory board is obliged to inform the shareholders and recommend a revocation. Furthermore, the auditor has a duty to warn[44] the directors and the members of the supervisory board in cases of severe violations of law.[45]

20 An *external audit*[46] may be decided on by the shareholders' meeting (by a majority vote[47]) or demanded by a minority of shareholders by application to the competent court.[48] In the latter case, it is necessary to furnish *prima facie* evidence for the misconduct. The competent court will decide whether the evidence furnished is sufficient.

21 The possibility of an external audit cannot be limited in the articles of association or in any other way.

II. Liability for Damage Caused to the Company and to the Shareholders

A. General requirements – scope of duties and violation of duty of care of directors

5. Liability of the board and its members

22 In general, directors and members of the supervisory board are *liable for all damage* caused to the company by a violation of their duties. A liability towards third parties (shareholders or creditors) is limited to certain cases (see below nos 58–64 and nos 124–150). One example is the violation of specific provisions which aim to protect creditors, like the obligation to file a petition for insolvency if the company is illiquid or overindebted (see below nos 134–141). However, in recent case law these 'exceptional' cases have increased significantly.

23 The applicable liability is primarily *based on law*[49] in connection with the relevant position as an organ, and not on the labour or service contract which is regularly concluded with the organ. Even if such a contract does not exist, the

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44 In German: *Redepflicht*.

45 See § 273(2) UGB.

46 In German: *Sonderprüfung* or *Revision*.

47 Shareholders who are directors or members of the supervisory board or who are controlled by such a person are not allowed to participate in this vote. See § 130(1) AktG, OGH 31.7.2015, 6 Ob 196/14p, and OGH 29.11.2016, 6 Ob 213/16s.

48 See §§ 130–133 AktG and §§ 45–47 GmbHG.

49 For stock corporations, see §§ 84 and 99 AktG; for limited liability companies, see §§ 25 and 33 GmbHG.

liability is not affected. In addition, violations of contractual duties or torts[50] can also be a reason for liability to the company.

The most important *deviation from the general principles* of liability is the specific and very strict duty of care which is imposed on the organs. The underlying rationale is the need for higher standards to be met by organs, this being deemed necessary in the interest both of the company and its creditors. Therefore, even if a director is an employee of the company in the strict sense (see below no 164), the specific provisions regarding the liability of employees,[51] according to which damages might be reduced or entirely denied, are not applicable.[52] 24

The *burden of proof* is on the organs.[53] The rationale for this provision is that the organs should know best what they did and why they did it. However, there is no uniform case law regarding the exact dimensions of the reversal of the evidence rule. If and to which extent there is a deviation from the general principles of the law of damages depends on the equally disputed issue of how the burden of proof in contractual relationships is to be attributed under Austrian law.[54] 25

Finally, the *Business Judgment Rule*,[55] which was explicitly incorporated into the Austrian Stock Corporation Act and the Austrian Limited Liability Companies Act by an amendment in the year 2015,[56] provides for specific principles with respect to business decisions: If the director acted in good faith in a reasonable way, based on an informed and disinterested judgment, the duty of care is deemed not to be violated (on this, see also below nos 43 and 52). The rationale behind this is the need for organs to take decisions and also to take some risks, without the danger of being held liable if the decision turns out to be harmful. However, it will be decisive how the Austrian courts apply this rule, particularly, what standards are applied for the test as to whether the organ was entitled to believe that the acts were in the best interest of the company. 26

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50 On this, see OGH 1.9.2015, 6 Ob 3/15g. In this case, the organ had committed the crime of embezzlement (*Untreue*, § 153 of the Austrian Criminal Code [*Strafgesetzbuch*, StGB]).

51 Austrian Statute on Liability of Employees (*Dienstnehmerhaftpflichtgesetz*, DHG).

52 See eg OGH 31.7.2015, 6 Ob 139/15g.

53 See § 84(2) 2nd sent AktG. This provision is applied by analogy also to organs of a limited liability company.

54 On this, see § 1298 ABGB.

55 On this, see § 84(1a) AktG and § 25(1a) GmbHG. For a comprehensive analysis, see *M Karollus*, Gesellschaftsrechtliche Verantwortlichkeit von Bankorganen bei Kredit- und Sanierungsentscheidungen – zugleich ein Beitrag zur Business Judgment Rule (§ 84 Abs 1a AktG und § 25 Abs 1a GmbHG), Österreichisches Bank-Archiv (ÖBA) 2016, 252–264.

56 Before that, similar principles had already been adopted in case law. See OGH 26.2.2002, 1 Ob 144/01k; 22.5.2003, 8 Ob 262/02s; 23.5.2007, 3 Ob 59/07h; 11.6.2008, 7 Ob 58/08t.

27 The aforesaid rules only apply to business decisions[57] for which the director is granted a scope of discretion,[58] whereas there is no such scope insofar as mandatory legal rules (eg the prohibition of repayments) or the allocation of competences (eg a required approval by the supervisory board or by the shareholders) are concerned.[59] According to the OGH,[60] the Business Judgment Rule is to be regarded as a general principle and therefore not only applies to stock corporations and limited liability companies, but also to other legal entities such as private foundations. For further details, see below nos 43 and 52.

6. General statutory and non-statutory duties of the board and its members

28 The organs (both the directors and the members of the supervisory board) are obliged to *act in the best interest of the company*, which means that they are obliged to take all measures to safeguard the company's interest, to make use of all opportunities, to prevent the company from being harmed,[61] overall to increase the company's profit in the long-term perspective[62] and to secure the existence of the company on a sustained basis.[63]

29 Furthermore, the organs are obliged to fulfil all *requirements imposed by law and by the articles of association*. Even violations of law which seem to be advantageous for the company at least at first sight (eg practices forbidden by antitrust law, under the condition that these practices are not discovered[64]) are strictly prohibited. On the other hand, a director can never be held liable for not adopting illegal measures. Even an explicit instruction to do so would be null and void (see below nos 88 and 92).

30 As for the Business Judgment Rule, see above nos 26 and 27.

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57 In German: *unternehmerische Entscheidung*.

58 On this, see also OGH 23.2.2016, 6 Ob 160/15w, drawing attention to the scope of discretion and the need to forecast risks.

59 This was confirmed by OGH 23.2.2016, 6 Ob 160/15w.

60 23.2.2016, 6 Ob 160/15w.

61 See eg OGH 9.1.1985, 3 Ob 521/84.

62 See OGH 22.5.2005, 8 Ob 262/02s. According to this decision, a long-term earning power is envisaged, as opposed to a short-term profit maximisation.

63 See OGH 22.5.2005, 8 Ob 262/02s.

64 If this was the case, heavy fines and damages for third parties would be the consequence.

7. Nature and scope of the duty to act in the best interests of the company

There is a general duty to safeguard the *interest of the company in all respects* (see above no 28). This general duty is concretized by several more specific duties.[65] 31

The duties may also include aspects of the board member's *private life*, as far as the interests of the company are affected. However, the evaluation of the extent of such duties as opposed to the board member's right of privacy may be tricky. 32

7.1. Case Study (safeguarding of interests)

It does not seem impossible that the director could be held liable by the company, especially in the mafia and the tax evasion case: a prudent and diligent director must know that such activities can also have adverse effects on the reputation of the company, and either there is no protected individual right to have personal business contacts with the mafia or to elaborate tax evasion strategies (particularly if they are illegal) or such is subordinated to the company's interests. Furthermore, the existence of any protected individual right to appear heavily drunk in public might also be contested. On the other hand, a person's love affairs seem to be within the very core of privacy. However, it will all depend on the *evaluation of interests on a case-to-case basis*. 33

7.2. Case Study (fiduciary duty and conflict of duties)

This case touches on the heavily disputed issue of a collision of duties.[66] It is not impossible that D is held liable at least for not issuing an unspecified warning. 34

8. The extent of the board's control and oversight

The board is *obliged to exercise control over employees* of the company in order to prevent any misconduct or violations of law. In this respect, a compliance system may be helpful or even required.[67] 35

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65 On this, see eg § 84(3) AktG and § 25(3) GmbHG, and many further duties which are provided for in said statutes and also in several other statutes.

66 For a comprehensive analysis, see *O Riss*, Doppelorganschaft und Treuepflichten (2008) *passim*, with further refs.

67 See also § 82 AktG and § 22(1) GmbHG, both calling for the implementation of an internal control system. For an analysis of the legal requirements under Austrian law, see *F Rüffler* in:

36 In bigger enterprises it has become usual to appoint a *compliance officer* on a level beyond the board who is responsible for compliance with these duties. In some fields of business, eg for insurance companies and issuers of securities, this is also required by law.

9. Responsibility for compliance monitoring

37 In practice, *individual directors* may be made responsible for a failure to fulfil compliance monitoring duties by means of a schedule of responsibilities, eg the director who is responsible for human resources; but see also above no 36 with respect to a compliance officer who is not a member of the board of directors.

38 However, even if one person is intended to be primarily responsible for compliance matters, *all members of the board* are at least responsible for monitoring whether these duties are fulfilled in a correct manner.

9.1. Case Study (liability of individual board members for disadvantageous transactions authorised by the majority in a board meeting)

39 In the *base case*, D1 and D2 can be held liable if the requirements of the Business Judgment Rule (see above nos 26 and 27) are not met. D3 cannot be held liable, at least not for the decision itself; it is possible, however, that D3 would have been obliged to take further measures to prevent the conclusion of the transaction, eg by informing the supervisory board.

40 In the *alternative case*, D3 could be held liable for not trying to convince D1 and D2 that their proposal is disadvantageous for the corporation.

10. Variation in duties and the standard of care expected of the board and its members under corporate, tort and contract law

41 The relevant standard of care is described in a general way as the standard of a conscientious and diligent business manager[68] or a conscientious businessman.[69] In order to comply with this standard, certain minimum abilities are re-

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E Artmann/F Rüffler/U Torggler (eds), Die Organhaftung zwischen Ermessensentscheidung und Haftungsfalle (2013) 18–24 with further refs.

68 *Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters*, see § 84(1) AktG.

69 *Sorgfalt eines ordentlichen Geschäftsmannes*, see § 25(1) GmbHG.

quired (see above no 16). Thus, an objective standard[70] is imposed, whereas general principles of tortious and contractual liability tend towards a more subjective standard based on individual responsibility.[71] The reason for this is the need to impose a high standard of care for organs.

The need for the organ to exercise its judgment or discretion when performing its duties is recognized by the Business Judgment Rule, which is designed specifically for business decisions. On this rule, and its rationale, see above nos 26 and 27. **42**

10.1. Case Study (concretisation of the standard of duty; Business Judgment Rule)

According to the Business Judgment Rule (see above nos 26 and 27), the decision must be taken *in good faith* (in the rational belief that it is in the best interest of the company) and based on an *informed and disinterested judgment*, ie with all appropriate information for such a decision and without a relevant conflict of interests. Therefore, liability cannot be imposed on the director if he acts in the belief that a certain decision will benefit the corporation and this belief is comprehensible and plausible in a normative sense. The assessment depends on how strictly these objective criteria are applied. In this respect, the existing case-law, according to which only gross misjudgement or absolutely unjustifiable decisions lead to liability, is still of relevance: the new statutes are to be understood in the same way, thus meaning that only decisions that are not plausible at all lead to liability, whereas the mere fact that the plausibility of the decision may in some way be questioned is not sufficient.[72] According to some scholars, liability only ensues in cases of gross negligence.[73] However, it may be disputed whether the explanation that 'slight' violations of the duty of care do not lead to liability is correct: as opposed to that, the prevailing opinion prefers the view that decisions which are not absolutely unjustifiable or based on gross misjudgement do not violate the duty of care at all. In any case, it all depends **43**

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70 *Objektiv-normativer Sorgfaltsmaßstab*, see eg OGH 26.2.2002, 1 Ob 144/01k = RIS-Justiz RS0116167.

71 § 1297 ABGB. However, a very important exception is § 1299 ABGB, imposing an objective standard on experts.

72 The statement of the OGH in its decision of 23.2.2016, 6 Ob 160/15w, that the decision made by the organ must obviously be in the interest of the company from an ex ante perspective, seems to be based on a misunderstanding. In the same decision, the OGH referred to the standards as already described.

73 See eg *G Schima*, Der Gesellschafter 2015, 292 f.

on the assessment of the competent judge, or to be more precise: of the court of last instance (see also below no 52). If the requirements of the Business Judgment Rule are met, the duty of care is not violated, even if the decision turns out to be harmful from an ex post view. Therefore, the Business Judgment Rule works as a sort of 'safe harbour'[74] for the organs. If the requirements of the Business Judgment Rule are not met, this does not automatically lead to liability: in this case, the decision is to be assessed according to the 'general' standard of care.[75]

44 *Not acting at all* and therefore missing all possible opportunities may also be a violation of duties and therefore lead to liability.

11. Factors influencing duties and the standard of care

45 The *facts and circumstances of the particular case* are decisive for the relevant standard of care.

46 Under established case law, the *business focus* of the company and its *size* are relevant factors for concretizing the standard of care.[76] For example, the OGH pointed out that for supervisory board members of a bank, the standard of care is different than for those of a regional brewery.[77] The same is likely to apply to the *purpose* of a company: for a non-profit company, the aim of increasing profits will not be relevant in the same way as for profit-oriented companies. Furthermore, the *importance and the financial dimension* of a decision are relevant factors for the required duty of care: for example, a large-scale M&A acquisition requires a market-standard due diligence.

47 The standard of care for executive and non-executive organs (members of the supervisory board) is significantly different. In the latter case, the duties are not focussed on the operation of the business, but on the supervision of the directors who operate the business. Furthermore, it is to be taken into account that members of the supervisory board usually act on a part-time basis only.[78]

48 All members of an administrative body are required to possess certain *minimum abilities* (see above no 16). However, the specific abilities of one member may influence the individual standard of care for this individual member. Furthermore, the other members may be entitled to rely on the expertise of the specialist.

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74 This term is explicitly mentioned in the official explanations for the statute.

75 § 84(1) AktG and § 25(1) GmbHG.

76 On this, see eg OGH 26.2.2002, 1 Ob 144/01k = RIS-Justiz RS0116167 and RS0116174; OGH 17.10.2003, 1 Ob 20/03b and 21.12.2010, 8 Ob 6/10f.

77 See OGH 26.2.2002, 1 Ob 144/01k.

78 On all that, see OGH 26.2.2002, 1 Ob 144/01k.

On the other hand, the *remuneration* received by the directors will not influence the standard of care.[79] A highly-paid director has to fulfil the same standards as a director with a salary which is below average. Even organs who do not receive any salary at all, like the members of the supervisory board who are appointed by the Works Council[80] (see above no 13), have the same duties as the other members. Nonetheless, the possibility cannot be excluded that the remuneration will have an influence on the court's assessment on a *case-to-case basis*, at least in the sense that the willingness to adopt the director's point of view may vary. 49

11.1. Case Study (applicable standard of care)

This question refers to the *legal standards which are relevant for directors*, particularly for a director of a bank: certainly, the standard of a person not involved in this business cannot be relevant. The standard of a person that is (at least) *familiar with this business* must be the minimum. If only this standard is applied, D would be liable in case (a), but not in case (b). 50

However, for a director of a bank, the relevant legal standard which is concretized specifically[81] in § 39(1) of the Austrian Banking Act[82] must be the *standard of a manager of a bank* and not the standard of a person who is merely familiar with the banking business, a standard which could perhaps be sufficient for members of the supervisory board. Therefore, D may then also be held liable in case (b). 51

In both cases liability would not ensue if the requirements of the *Business Judgment Rule* (see above nos 26 and 27) were met. However, at least at first sight this does not seem to be the case: if it was foreseeable for a manager of a bank that the transaction would be adverse for B-Bank, one cannot say that the director acted in good faith in a reasonable fashion, ie that he was entitled to rely on positive effects of the transaction for the company. It might be relevant, however, to what extent the adverse outcome was probable or even highly 52

79 OGH 31.7.2015, 6 Ob 139/15g: Even unusually low remuneration does not affect the director's duties. However, for registered associations, see § 24(1) 2nd sent VerG, stating that an organ acting without remuneration shall be held liable only for gross negligence or bad intent.

80 A remuneration of these members is forbidden by law, see § 110(3) 1st sent ArbVG.

81 Apart from a general reference to § 84(1) AktG, § 39(1) of the Austrian Banking Act deals specifically with the directors' obligation to control the risks of the banking business and their duty to take into account the total proceeds of the bank.

82 *Bankwesengesetz*, BWG.

probable, or if there was only a foreseeable, but minor, possibility of an adverse outcome, whereas the chances of a favourable outcome seemed to be significantly higher; in the latter case, one could not speak of gross misjudgement or an absolutely unjustifiable decision on the part of the director, and therefore the requirements of the Business Judgment Rule seem to be met. It would also have to be taken into account how severely the company would have been affected in the worst case scenario (only a reduction of profits or an existential threat to the company?), what outcome of the transaction could have been expected at best and what the likelihood of such an outcome was. Based on these facts, the judge must evaluate whether the decision taken by the organ was absolutely unjustifiable and not at all plausible; the mere fact that the judge personally would have decided otherwise is not sufficient for liability. These criteria show that in real life the assessment of business decisions will often not clearly be black or white, but rather different shades of grey.

12. The boards' and its members' duties and liability in the vicinity of insolvency

53 The *directors are obliged to* (1) make their best efforts to prevent the company from becoming insolvent,[83] (2) investigate whether a state of insolvency, ie illiquidity[84] and/or over-indebtedness,[85] has been reached, and, if the company is insolvent, (3) file a petition for insolvency[86] and (4) refrain from taking any actions that could be harmful to the company and its creditors.[87] All directors are bound to fulfil the duty to file a petition for insolvency, irrespective of any schedule of responsibilities,[88] and irrespective of the power of attorney as well.[89]

54 If the obligation to file a petition for insolvency is violated, the directors can be held liable by the company or by the insolvency receiver on behalf of the company (its insolvency estate) *for the loss suffered*, eg for further losses suffered by the company after the petition for insolvency should have been

83 See also § 159(1) StGB.

84 See § 66 IO.

85 See § 67 IO.

86 See § 69 IO.

87 See also § 159(2) StGB.

88 See eg OGH 5.4.1989, 1 Ob 526/89; 31.7.2015, 6 Ob 139/15g; 31.7.2015, 6 Ob 139/15g.

89 Even a director who does not have a single-signing authority is entitled and obliged to file a petition for insolvency if the requirements are met, see OGH 5.4.1989, 1 Ob 526/89.

filed,[90] or for payments made to individual creditors in the state of insolvency.[91]

As for liability to creditors, see below nos 134 to 141. 55

13. Impact of selection criteria on duties and the standard of care

It is not impossible that selection criteria for organs may influence the relevant standard of the duty of care, at least in the way that specific requirements regarding professional experience and training may lead to a higher standard. On the other hand, the minimum standards required by law and by case law (see above no 16) cannot be diminished: Even if the articles of association[92] require that only shareholders may be directors, and no shareholder has the necessary abilities to comply with the legal standards, the directors will be liable according to the legal standards anyway. The same applies if such a person is directly appointed as a director in the articles of association (on this, see also below no 57). 56

Such restrictions may be provided for in the articles of association, as far as they do not violate any mandatory provisions or basic principles of law. Furthermore, in a limited liability company it is also possible to appoint shareholders as directors directly in the articles of association.[93] 57

14. Compensation for damage to the corporation's property or to shareholders'/partners' property

As already stated above no 22, organs are in general *only liable towards the company*, whereas liability towards shareholders is restricted to specific cases.[94] Therefore, the director will be liable to the company for loss or damage of its property if the duty of care is violated. On the other hand, shareholders are in 58

90 On this, see OGH 28.6.1990, 8 Ob 624/88.

91 On this see § 84(3) no 6 AktG and § 25(3) no 2 GmbHG; OGH 11.4.1972, 5 Ob 38/72 and 31.7.2015, 6 Ob 139/15g.

92 For registered co-operative societies, such a requirement is even imposed by law (§ 15(1) GenG, stating that only members of the co-operative society or authorized organs of a member may be directors of the co-operative society). However, this does not affect the relevant standard of care: the co-operative society is free to admit the prospective directors as new members, and therefore said provision does not limit the free choice of organs in practice (on this, see also *O Riss*, Österreichisches Recht der Wirtschaft (RdW) 2008, 768–770, with further refs).

93 See § 15(1) 4th sent GmbHG.

94 See eg § 100 AktG.

general not entitled to claim damages from the directors based on a breach of their duties which they have vis-à-vis the company. The reason for this is that the directors' duty of care is legally designed to apply only internally, towards the company. Therefore, a shareholder can neither claim damages for the decrease in the value of his shares resulting from damage caused to the company, nor for losses that do not only reflect the company's damage because, in general, there is no legal foundation for such a claim. However, in the case of loss or damage of the shareholders' property, the prerequisites for a tort claim could be fulfilled: if the director negligently destroys the shareholder's property, eg his car, the director will be liable in tort to the shareholder in the same way as anybody else would be liable for such an act.

59 Particularly, the director is *not liable to the shareholders for a decrease of value of their shares*.[95] The decrease of value of the shares may be compensated in an indirect way by the compensation paid to the company, thus possibly leading to a corresponding increase of value of the shares.

14.1. Case Study (compensation for damage to the corporation's property or to shareholders'/partners' property)

60 Only C-Corporation can claim damages from D, but not its shareholders S1 and S2 (see above nos 58 and 59).

61 In the *alternative case*, there are no damage claims at all, insofar as C-Corporation does not suffer consequential losses due to the misconduct which could give rise to a claim for damages on the part of this company, eg due to missing further business opportunities because C-Corporation has lost its reputation due to D's misconduct, so that nobody wants to make business deals with C-Corporation anymore. The decrease of value of the shares which is suffered by the shareholders is not indemnifiable (see above no 59).

14.2. Case Study (compensation for damage to the corporation's property or to shareholders'/partners' property due to delay in filing for insolvency)

62 *C-Corporation* (the insolvency receiver on its behalf, ie precisely on behalf of C-Corporation's insolvency estate) may file damages claims against D based on the further damage incurred by the company (see above no 54).

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95 On this, see OGH 20.11.1991, 1 Ob 617/91 and 11.9.1997, 6 Ob 244/97v.

On the other hand, the *shareholders* (S1 and S2) are not entitled to file damages claims against D (see above nos 58 and 59). **63**

As for liability to *creditors*, see below nos 134 to 141. **64**

15. Limitation periods

For stock corporations and limited liability companies, the *limitation period is five years*.[96] The relevant provisions do not provide an answer to the question of when this period shall start to run. According to established case law, the limitation period does not start to run with the damaging event, but when the company (ie persons whose knowledge is attributed to the company; the knowledge of those persons who are liable for the damage is not attributed to the company;[97] therefore, only the knowledge of other directors or members of the supervisory board or perhaps also of shareholders[98] could be relevant) has gained knowledge of the damage and of the person liable for it, which also includes the basic reasons for this person being liable.[99] In practice, this knowledge is very often only gained after a change in management or after insolvency proceedings have been opened, thus leading to a significant extension of the relevant limitation period. **65**

The main reason for the five-year period (which is quite an unusual term in Austrian private law) is that the relevant provisions were imported or at least copied from German corporate law. The reason for the case law approach regarding the starting point is the aim of understanding these provisions in a way that is compatible with Austrian law (on this, see below no 67). However, Austrian case law is not consistent because the similar five-year period for auditors[100] which originally was also imported from German law is deemed to start with the time of the damage being incurred, irrespective of when the company gained knowledge of that.[101] **66**

The general limitation period for damage claims in Austrian law is three years from the point when the damaged person has gained knowledge of both **67**

96 See § 84(6) AktG and § 25(6) GmbHG.

97 See eg OGH 27.9.2006, 9 ObA 148/05p. The reason is that it would contravene basic principles of law and justice to attribute the organ's knowledge to the company in order to start the limitation period for the company's claims vis-à-vis the organ.

98 See OGH 27.9.2006, 9 ObA 148/05p.

99 On this, see RIS-Justiz RS0034322 (to § 1489 ABGB in general).

100 See § 275(5) UGB.

101 See eg OGH 23.1.2013, 3 Ob 230/12p (with the exception of intentional breaches: in such a case, the period also starts to run only at the time when the aggrieved party has gained knowledge of the damage and of the person liable for it).

the damage and the person liable for it. In the case of criminal offenses[102] which can only be committed by intent and provide for a penalty of imprisonment of more than one year, the relevant period is thirty (or even forty) years. Furthermore, the ultimate limitation deadline (if knowledge has not been gained before) is also thirty (or even forty) years.[103]

68 This general limitation period applies if the organ is held liable in tort.[104]

15.1. Case Study (suspension/interruption of the limitation period)

69 With respect to the *first case* study, the answer depends on the other directors' and/or the supervisory board members' knowledge both of the damage caused by the negligently concluded transaction and D as the person liable for it. In general, the limitation period will not start to run before people whose knowledge can be attributed to the corporation (directors or members of the supervisory board who were not involved in the misconduct, see above no 65) have gained knowledge of the damage and of the person liable for it. As the case study does not give any facts on the (missing) knowledge of persons other than shareholders, the starting point of the limitation period cannot be assessed conclusively. According to Austrian case law, the shareholders' knowledge can also be relevant with respect to the starting point of the limitation period.[105] However, said case law concerned the breach of duty of the only director of a limited liability company.

70 In the *alternative case*, neither the members of the executive nor the supervisory board, nor the shareholders have gained knowledge of the misconduct, with the consequence that the limitation period has not yet started to run. On the other hand, the limitation period will start to run as soon as the relevant persons who were not involved in the misconduct gain the necessary knowledge.

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102 A conviction is not required: It is sufficient that the crime is proven in civil law litigation. On the other hand, under Austrian law a criminal conviction also has a binding effect for the civil litigation; see eg OGH 1.9.2015, 6 Ob 3/15g. The organ may no longer contest the facts on which the conviction is based.

103 See § 1489 ABGB.

104 On this, see OGH 1.9.2015, 6 Ob 3/15g. In this case, the director had committed the crime of embezzlement (*Untreue*, § 153 StGB) to the detriment of the company.

105 See OGH 27.9.2006, 9 ObA 148/05p and 20.2.2014, 6 Ob 183/13z.

B. Modification of the general conditions for liability

16. Adapting the scope and content of the board's and its members' duties

71 According to prevailing opinion, the *content and the scope of duties* deriving from company law are *mandatory*[106] and may therefore not be altered – or at least not diminished – by the articles of association, by shareholders' resolutions or by the labour or service contract which is concluded with the director. The internal legal relationship to the company is not relevant for the director's duties.[107]

16.1. Case Study (distribution of competences)

72 In the case of a valid allocation of duties, which would require the consent of the organ that is responsible for the appointment of the directors (supervisory board in the case of a stock corporation and shareholders in the case of a limited liability company), D2 will be primarily responsible for the respective duties. However, the other director (D1) still remains liable for the supervision of the areas for which other directors are competent.

73 In *Alternative 1*, D2 concluded a transaction without being competent for such a transaction. Therefore, D2 is liable for all damage suffered from this transaction, irrespective of whether he knew or ought to have known that the transaction was disadvantageous. D1 could only be held liable if he violated any supervisory duties, which cannot be assumed according to the given facts.

74 An agreement merely concluded between individual members of the board (*Alternative 2*) is irrelevant for the legal relationships towards the corporation.[108] Therefore, D1 can be held liable for the damage caused by the transactions if a diligent director would not have entered into these transactions (D1 would not be liable for the transactions concluded by D2 if he had not been liable in the case that he himself had concluded these transactions).

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106 See eg OGH 31.7.2015, 6 Ob 139/15g. In contrast to this, some legal scholars hold the view that in limited liability companies the principle of party autonomy shall prevail. See eg *HG Koppensteiner/F Rüffler*, GmbH Gesetz Kommentar (3rd edn 2007) § 25 no 25.

107 OGH 31.7.2015, 6 Ob 139/15g.

108 See OGH 31.7.2015, 6 Ob 139/15g, on an agreement with a third party who allegedly dominated the company.

16.2 Case Study (authorisation of unlawful conduct)

75 An *authorisation* of unlawful conduct (or an obligation to act this way) in the articles of association and/or in the employment contract *will not be valid*; moreover, the organs are strictly obliged to obey all laws (see above no 29). Therefore, D is liable for all damage incurred by the company due to unlawful conduct. The same applies to an authorisation of unlawful conduct given by shareholders' resolution, with the consequence that D would be obliged not to make use of such an authorisation.

76 As for fines, it could be doubtful, however, whether the rationale behind them allows them to be shifted to other persons.[109]

77 On the other hand, D cannot be held liable for observing the laws.

17. Adapting the standard of care expected of the board and its members

78 According to prevailing opinion, the answer is *no* (see above no 71).

17.1. Case Study (reduction of due diligence standard)

79 According to prevailing opinion, such agreements with the corporation *cannot be effective* (see above no 71).

18. Other limitations or exclusion of liability

80 The only possible way is that *third parties* (eg a parent company or another shareholder) enter into an agreement with the board member providing for the member to be held harmless against damage claims raised by the company.

81 However, in the case of criminal offenses or other severe violations of law, even such an agreement with a third party may be unlawful and invalid.

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109 See also § 11 of the Austrian Code on the Criminal Responsibility of Organisations (*Verbandsverantwortlichkeitsgesetz*, VbVG), stating that criminal fines imposed on organisations may not be reimbursed by organs or employees.

18.1. Case Study (other limitation of liability)

As stated above nos 78 and 79, such exclusions or limitations are *invalid*. The recent discussions in Germany on a reduction of excessive claims[110] seem not to have spilled over to Austria. In any case, there is no legal basis for such a reduction on the basis of the *lex lata*. The only alternative could be an agreement with third parties, see above nos 80 and 81. **82**

C. Authorisation and instructions by other organs of the company (in particular by the shareholders' meeting)

19. Powers and responsibilities in authorising and instructing the board

Both for stock corporations and limited liability companies, *certain decisions* of the directors need to be *approved by the supervisory board*.[111] Some of these matters – for example transactions in enterprises and shareholdings, transactions in real estate, the establishment and foreclosure of branches, investments or the taking up and granting of loans – are already determined by law, with the possibility or necessity for the articles of association and for the supervisory board to establish floors in certain cases. Both in the articles of association and by a resolution of the supervisory board, further matters may be made subject to the supervisory board's approval. It is regarded to be one of the duties of the supervisory board to check if and which further matters should be made subject to approval. **83**

When deciding on the approval, the members of the *supervisory board* are bound by the same duty of care as in other cases, ie to act in the best interest of the company.[112] This also implies that they must act based on sufficient information. The Business Judgment Rule (see above nos 26 and 27) applies to the members of the supervisory board, too. **84**

In *stock corporations*, an approval by the shareholders' meeting is required only in exceptional cases, like the alteration of the articles of association,[113] the **85**

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110 On this, see eg *H Fleischer* in: G Spindler/E Stilz, Kommentar zum Aktiengesetz (AktG) (3rd edn 2015) § 93 nos 9a–9c (discussing proposals *de lege ferenda*, and rejecting most of them).

111 On this, see § 95(5) AktG and § 30j(5) GmbHG.

112 See also *S Kalss* in: P Doralt/C Nowotny/S Kalss, Kommentar zum Aktiengesetz (2nd edn 2012) § 95 no 101 AktG.

113 § 145 AktG.

increase or decrease of capital,[114] a merger or demerger,[115] the issuance of convertible bonds or profit participating bonds,[116] and the sale of the whole assets of the corporation.[117] Under Austrian law it is still not clear whether the German 'Holzmüller' doctrine, stating that other measures severely affecting the shareholders' rights are subject to approval by the shareholders, is applicable.[118] In any case, the directors or – if the matter is subject to approval by the supervisory board (see above no 83) – the supervisory board may on their own initiative, leave a matter to the shareholders' meeting to decide on. It is not possible to create further cases of required shareholders' approval in the articles of association.

86 In limited *liability companies*, the law sets out that many more matters are subject to approval by the shareholders.[119] According to established case law, the same applies to extraordinary measures in general.[120] Furthermore, in the articles of association further matters that require the shareholders' approval may be determined, something which happens very often in practice.

19.1. Case Study (authorisation of an apparently disadvantageous transaction)

87 *Approval by the supervisory board* will never have the effect of liberating the directors from liability.[121] Moreover, the members of both organs would be liable if all of them violated their duty of care. In the case of the members of the supervisory board, this depends on their knowledge and on what they should have known in the particular case. Therefore, they may not be liable in *Alternative 1*, but may be liable in *Alternative 2*, provided that further investigations would have been required.

88 In the case of *approval by the shareholders*, the directors and the members of the supervisory board are liberated from liability if (1) the shareholders were provided with correct and full information and (2) the corporation does not lose

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114 § 149 ff and § 175 ff AktG.

115 § 219 ff AktG and the *Spaltungsgesetz* = Austrian Demerger Act.

116 § 174 AktG.

117 § 237 AktG.

118 This issue was once again explicitly left open by OGH 9.10.2014, 6 Ob 77/14p.

119 See eg § 35 GmbHG.

120 See OGH 23.5.2007, 3 Ob 59/07h.

121 Explicitly § 84(4) 2nd sent AktG.

its ability to fulfil all its obligations within the limitation period for damage claims (on this, see above no 65): in the latter case, the creditors of a stock corporation will be entitled to pursue the corporation's claims notwithstanding the shareholders' consent,[122] and in the case of a limited liability company the waiver of the damage claims is invalid[123] (see also below nos 110 and 111). Furthermore, if the shareholders' resolution violates mandatory law (eg the prohibition of repayments), it is invalid and therefore the liability of the directors and the members of the supervisory board is not affected.[124]

89 In both alternatives, the information given by D was not correct, and therefore the shareholders' approval could not have the effect of liberating D from liability.

20. Instructions to the board or individual directors to implement certain management decisions

90 In *stock corporations*, the directors act autonomously[125] and therefore no other organs are entitled to give instructions with any binding effect to the directors. Such instructions may only be taken as mere recommendations. It is up to the directors to decide on their own responsibility, whether they will comply with such recommendations or not. If they do so, liability cannot be avoided by referring to such a recommendation as the cause of a decision.

91 In *limited liability companies*, the shareholders (by resolution, not individual shareholders[126]) may give instructions to the directors.[127] The same applies to the supervisory board if the articles of association confer this power to the board.[128]

92 A director acting on an instruction is not liable for doing so unless (1) the corporation is not able to fulfil all its obligations or loses its ability to do so within the limitation period for damage claims (on this, see above no 65) or (2) the instruction violates mandatory rules of law and therefore is invalid (see

122 See § 84(5) 3rd sent AktG.

123 See § 25(7) GmbHG in connection with § 10(6) of said statute.

124 See § 199 AktG. For a limited liability company, see OGH 22.10.2003, 3 Ob 287/02f.

125 See § 70 AktG.

126 Even an instruction rendered by the majority shareholder is legally irrelevant. In the case of a sole shareholder, the instruction may be understood as being an 'informal' shareholders' resolution and may therefore be valid. The same applies to an instruction which is rendered by all shareholders.

127 See § 20(1) GmbHG.

128 See §§ 20(1) and 30k(4) GmbHG.

above no 88). Furthermore, a director could also be liable for not challenging a resolution which contravenes the interest of the company.[129]

93 Members of the *supervisory board* may be liable for instructions given by the supervisory board which were not in line with their duty of care.

94 It is not clear whether the same applies to shareholders. According to case law, at least a majority shareholder or a parent company may be liable to the company for negligent instructions.[130]

20.1. Case Study (instructions regarding illegal/disadvantageous management decisions)

95 Said instructions violate mandatory rules of law and therefore are invalid (see also above nos 29, 75 and 88). The director is not exempted from his liability vis-à-vis the company. Furthermore, the members of the organ which gave the instruction may be liable (see above nos 93 and 94).

96 As for the issue of whether the liability may also include fines, see above no 76.

97 In the alternative, D cannot be held liable for ignoring the invalid instruction and for observing the laws (see above no 77).

20.2. Case Study (instructions regarding distribution of profits)

98 In a *stock corporation*, it is up to the shareholders to decide on the distribution of profits.[131] A majority vote as in the case at hand would be sufficient. In a *limited liability company*, a shareholders' resolution concerning the distribution of profits is only necessary if the articles of association provide for this.[132] Otherwise, the whole profit as it is shown in the balance sheet is to be distributed automatically to the shareholders. In the present case it is assumed that a shareholders' resolution is required. This requirement is fulfilled by said resolution.

99 However, the shareholder S3 and the director could *challenge the resolution* with the argument that it contravenes the duty of loyalty. It seems possible that the director could be held liable for not taking this step.

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129 But see *Koppensteiner/Rüffler* (fn 106) § 20 no 9 and § 25 no 17 (denying an obligation to challenge the resolution), with further refs.

130 See OGH 12.4.2001, 8 ObA 98/00w and 19.12.2002, 2 Ob 308/02m.

131 See § 104(4) AktG.

132 See § 35(1) no 1 GmbHG.

Furthermore, the director could be held liable if he did not even try to *inform the shareholders* about the fact that the company needed the funds and warn them about the adverse effects of the envisaged distribution of the profits. **100**

In a stock corporation, the directors and the supervisory board *decide on the annual accounts*.[133] Therefore, it would be up to the directors and the supervisory board to add these funds to the reserves, which would mean that there would be no distributable profit in the annual accounts. In a limited liability company, the shareholders decide on the annual accounts,[134] so they have the last word. **101**

As for the liability of individual shareholders, see above no 94. The basic principle is that *shareholders are not responsible for their votes cast* in the shareholders' meeting.[135] However, if specific duties of care or duties of loyalty are violated, shareholders may be liable. **102**

20.3. Case Study (instructions regarding covert return of contributions)

At least in the *base case* and in *Alternative 1*, the transaction violates the mandatory prohibition of repayments (*Verbot der Einlagenrückgewähr*):[136] apart from an open distribution of profits and some further exceptions, no funds must be transferred to the shareholders; transactions between the company and a shareholder which have this effect are equally forbidden. Therefore, the shareholders' resolution is null and void (see above nos 88 and 92). In a limited liability company, a further reason for invalidity of the resolution (or at least for a right to challenge it) could be that S1 was not entitled to give his vote on a transaction to be concluded between the company and himself.[137] Director D would be liable to the company for executing the transaction. Furthermore, S1 would be liable for all advantages gained, based on the prohibition of repayments.[138] It is not clear whether S1 and S2 could also be liable for damages. A possible basis for their liability could be the illicit instruction given by the shareholders who together held the majority of the votes (see also above no 94). S3 is not liable because he did not vote in favour of the resolution. The 'share- **103**

133 See § 96(4) AktG. The shareholders' meeting is only competent if the directors and the supervisory board disagree, or if they decide to refer the issue to the shareholders' meeting, see also § 104(3) AktG.

134 See § 35(1) no 1 GmbHG.

135 See also § 101(3) AktG, stating that §§ 100 and 101 do not apply if an adverse influence is exercised by means of casting a vote in the shareholders' meeting.

136 See § 52 AktG and § 82 GmbHG.

137 On this, see § 39(5) GmbHG.

138 See § 56 AktG and § 83 GmbHG.

holders' meeting' cannot be liable due to its lack of legal personality and legal capacity.

104 In *Alternative 2*, it is not clear whether the prohibition of repayments can apply to a transaction with the majority shareholder's spouse. If this is the case, the results would be the same as above no 103.

105 If not, D would nevertheless be liable because (1) it is highly probable that S will challenge the shareholders' resolution, thus having the effect that the resolution is set aside with retroactive effect if the court grants the challenge. This will very likely be the case due to the prohibition on D giving his vote and the at least detrimental and highly disloyal character of the transaction, and (2) in his position as a director D is obliged to challenge the resolution as well. Furthermore, D may also be liable as the dominating shareholder who gave the instruction that was harmful to the company (on this, see above no 94).

20.4. Case Study (instructions regarding covert return of contributions within a group of companies)

106 In all these cases the *loan violates the prohibition of repayments*. An interest-free loan to a shareholder or to a company controlled by the shareholder is never allowed. Furthermore, the solvency of A-Corporation was at least doubtful, so that a loan without collaterals was forbidden. The prohibition also applies to transactions with the sole shareholder or with the consent of the sole shareholder. Therefore, the shareholders' resolution is null and void.

107 *Director D* would be liable to the company (C-Corporation) for granting the loan to A-Company. He violated his duties as a director by breaching the prohibition of repayments.

108 Furthermore, it is highly probable that the *shareholder M-Corporation* could also be liable, based both on the prohibition of repayments (because the loan granted to A-Corporation may as well constitute a donation to its shareholder M-Corporation, thus leading to an obligation of M to repay the funds) and in damages.

D. Waiver of and agreement regarding indemnity

21. Right and scope of waiver against board and its members

109 In general, the same organs as those competent to raise a claim (on this, see below nos 154 to 156) would be competent to conclude an agreement on a waiver

of damage claims. Furthermore, in most cases this organ needs the consent of the shareholders.

In a *stock corporation*, in the case of directors who are still in this position, **110** a waiver agreement is to be concluded by the supervisory board. In the case of former directors, it is disputable whether the supervisory board or the new directors are competent to conclude the waiver agreement.[139] In addition, a waiver agreement can only be concluded after five years from the emergence of the damages claim with the shareholders' consent and provided a minority of 20% does not object to the waiver.[140] The five-year period does not apply if the organ is insolvent and makes an arrangement with creditors in order to avoid insolvency.[141] It is disputed whether the same applies to a unanimous vote by all shareholders which either approves a waiver agreement or declares an exoneration of the directors.[142] In any case, the waiver is not fully effective if the company is not able to fulfil all its obligations or if it loses its ability to do so within the limitation period for damage claims (on this, see also above no 65): a creditor of the company may pursue the damages claim irrespective of the waiver[143] if the breach of duty was either grossly negligent or the duties enumerated in § 84(3) of the Austrian Stock Corporation Act were violated.[144] On the other hand, the waiver remains valid for the company's claims.

In a *limited liability company*, the waiver agreement is either concluded by **111** the supervisory board or by special representatives appointed by the shareholders. Furthermore, according to some authors, other directors are also competent to act on behalf of the company.[145] It is not clear either who represents the company in the case of former directors.[146] The waiver needs approval by the

139 See eg AktG/*Kalss* (fn 112) § 97 no 21, with further refs (on the issue of who is competent to represent the company in general).

140 § 84(4) 3rd sent AktG.

141 § 84(4) 4th sent AktG.

142 A waiver was affirmed in OGH 3.7.1975, 2 Ob 356/74. However, in OGH 1.9.2015, 6 Ob 3/15g this issue was explicitly left open (the effect of a waiver was in any way denied because the illicit acts had not been known by all shareholders). The issue of whether unanimous exoneration may have the effect of a waiver in a stock corporation is heavily disputed in legal literature. In German law, the legislator has decided the issue by explicitly stating that in a stock corporation an exoneration does not have the effect of a waiver (§ 120(2) 2nd sent of the German Stock Corporation Act).

143 § 84(5) 3rd sent AktG.

144 § 84(5) 2nd sent AktG.

145 See *Koppensteiner/Rüffler* (fn 106) § 30l no 1, with further refs.

146 See *Koppensteiner/Rüffler* (fn 106) § 30l no 3, with further refs, stating that former directors are not governed by § 30l GmbHG.

shareholders (a shareholders' resolution).[147] A resolution on exoneration of the directors would have the same effect if the damages claims were known to the shareholders or they ought to have known of them.[148] In this case, no separate waiver agreement needs to be concluded, but the resolution itself has this effect. However, in all these cases the waiver is not valid if the company is not able to fulfil all its obligations or if it loses its ability to do so within the limitation period for damages claims (on this, see above no 65): creditors of the company who put an execution lien on the company's claims or the insolvency receiver are not bound by the waiver.[149] Furthermore, minority shareholders pursuing a claim based on § 48 GmbHG are not barred by a waiver, at least if the waiver took place after the minority shareholders had begun to pursue their rights.[150]

21.1. Case Study (waiver of right to pursue already incurred claims)

112 See above nos 110 and 111: an agreement concluded with the shareholder(s) does not constitute a waiver which is binding for C-Corporation. This would require that (a) the supervisory board of C-Corporation or a special representative appointed by the shareholder(s) conclude an agreement with D in the name of the company, which is approved by the shareholder(s), or that (b) the shareholder(s) pass a resolution on exoneration.

113 In the present case, if C-Corporation is a *limited liability company*, the conduct of the sole shareholder (the agreement concluded with the director) may be understood as already constituting an informal shareholder's resolution, which would at least in general be possible in a limited liability company. In a *stock corporation*, this is not possible because resolutions can only be passed in a formal shareholders' meeting, certified by a notary public. 'Informal' or 'tacit' resolutions are not recognized.

114 A resolution on exoneration would only be sufficient in the *alternative case* because such a resolution only means a waiver of claims which were at least foreseeable to the shareholders at the time of the resolution. In the base case, a general waiver agreement[151] would be required in order to include the unforeseeable claims as well.

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147 § 35(1) no 6 GmbHG by analogy.

148 See eg OGH 17.5.1992, 9 ObA 105/92.

149 § 25(7) GmbHG in connection with § 10(6) of said statute.

150 See OGH 13.1.1982, 1 Ob 775/81. The issue of if and when the minority right is affected by a waiver is heavily disputed in legal literature.

151 In German: *Generalbereinigung*.

If C-Corporation is a *stock corporation*, the effectiveness of a waiver (in both cases) also depends on the disputed issue of whether such a waiver, which is approved of with the consent of all shareholders or the sole shareholder, is deemed to be effective, even if the requirements of § 84(4) of the Austrian Stock Corporation Act are not met (on this, see above no 110). 115

22. Indemnifying the board and its members from liability vis-à-vis third parties in the event of prosecution

It is highly doubtful whether an indemnification agreement providing for *compensation* to a director who committed illicit acts is in line with the basic concept of directors' liability, according to which the director is obliged to strictly comply with the law (see above no 29) and to compensate the company for all damage incurred by unlawful acts. Therefore, at least in cases where the acts or omissions of the director were also unlawful vis-à-vis the company, an indemnity agreement will very likely be regarded as a violation of basic principles of corporate law, ie the mandatory responsibility of the organs. 116

An indemnification for *fines* imposed on a director poses further problems, as the indemnification might contravene the purposes of the fine which is meant to be an evil inflicted personally on the convict. Therefore, such an indemnification agreement could be invalid.[152] Particularly an indemnification agreement which was concluded before the acts or omissions were undertaken might be unlawful because it might be an incentive to commit such acts. 117

For *costs of defence in criminal proceedings* (legal representation costs and court fees), the purposes of the fines are not equally relevant, and therefore an indemnification for these costs might be treated in a more favourable way. A solution which will raise no doubts could be to agree on advance payments which must be repaid (only) in the case of a conviction. 118

In a stock corporation, the supervisory board *represents the corporation* in connection with any indemnification agreement with a director; in a limited liability company, the company is represented by the shareholders' meeting. 119

152 But see also *S Kalss* in: P Lewisch (ed), Jahrbuch Wirtschaftsstrafrecht und Organverantwortlichkeit (2015) 73–97 with further refs, proposing to allow such agreements if certain conditions are met.

22.1. Case Study (limits of indemnity provisions)

120 See above nos 116 to 118. Due to the reasons stated therein, it is very doubtful whether and to what extent the indemnification agreement is valid.

121 Particularly, the agreed indemnification for *fines* will very probably be invalid. Costs of *legal representation, court fees and compensation of damage* paid to a third party may be treated in a more favourable way. However, also in these cases doubts may remain, particularly if the conduct of the director was unlawful vis-à-vis the company as well.

122 Without an indemnification agreement (or without a valid agreement), an obligation of C-Corporation could possibly be based on § 1014 ABGB, stating that the *principal is obliged to reimburse the agent for expenses and for damage incurred due to the mandate*. However, in this context similar issues of whether certain expenses may be shifted to the principal arise: in the case of fines, their purposes seem to be an argument against them being shifted to the company. As for legal costs of representation, court fees and damages paid to third parties, it could be decisive whether the conduct of the director also constituted a breach of duties vis-à-vis the company: if this was the case, one could argue that the director would have to bear all expenses on his own because by receiving reimbursement from the company he would cause damage to the company, which would then have to be compensated by him.

123 Furthermore, if both D and C-Corporation are liable for damages to the third party, § 896 ABGB regarding the *right of recourse between joint debtors* is relevant. In this respect, primarily the specific relationship between the joint debtors is decisive; only if this does not lead to a solution does each joint debtor have to assume an equal portion. In the case at hand, it must be taken into account that the director's acts which are attributed to the company are the very reason why the company is liable for damages to a third party. Therefore, at least if the conduct of the director also constituted a breach of duties vis-à-vis the company, good reasons support the view that the director has to assume liability for all damages.

III. Liability for Damage to Third Parties

23. Board's liability towards third parties

124 As already stated above no 22, the directors are in general only liable for damages to the company, and not to third parties. However, in certain cases – which have increased significantly during the last decades – liability to third parties may arise: (1) The most important example is the *violation of legal provisions*

that aim to protect certain persons,[153] eg creditors. (2) Furthermore, under specific circumstances, the organ could be liable for *culpa in contrahendo* (on this, see below no 127) and (3) finally, the organ could be liable to a third party if *legally protected rights*[154] of this person are impaired (on this, see below no 125). It can be summarized that there is no contractual liability to third parties (because the legal relationship is between the organ and the company only), whereas liability based on tort or on *culpa in contrahendo* (which is at least somewhere in between tort and contractual liability) to third parties may arise.

23.1. Case Study (board's instruction to provide inappropriate advice by sales representatives)

In case (b) D is liable in tort to P because he contributed to the *physical injury* of P, which means that legally protected rights of P – which are protected against everybody – were infringed. The instructions given to the employees are sufficient for D's liability because, by instructing the employees, D also contributes to P being injured. The same applies to the alternative where *D directly participates in the sales* (and, as it may be assumed, personally gives the inappropriate advice to P). Negligence is sufficient for liability; intent of D is not required. **125**

In case (a), no legally protected right of P is infringed, but P ends up with a *mere economic loss*. In such a case, liability of D to P would be possible if the criminal offense of betrayal[155] was fulfilled, which would require *inter alia* intent (to deceive somebody, to cause damage to him and to unjustly enrich oneself or a third party): this legal provision aims to protect the person who is betrayed and therefore the betrayed person is entitled to claim damages from the person who committed the crime. Also in this case, the instructions given to the employees to provide inappropriate information would be sufficient. Even if D did not have the intent of unjust enrichment, D would be liable in the same way based on intentional deceit.[156] **126**

If D did not know that the information was wrong, he would be liable for damages to P only under specific circumstances: in general, organs are *not personally liable for negligently misleading third parties*.[157] Only the prospective con- **127**

153 In German: *Schutzgesetze*, see § 1311 ABGB.

154 In German: *absolute Güter*.

155 *Betrug*, see § 146 StGB.

156 See § 874 ABGB.

157 The same applies to Austrian civil law in general: the representative is in general not liable for negligently misleading third parties who enter into a transaction with his principal,

tractual partner, ie C-Corporation, is bound by pre-contractual duties (*culpa in contrahendo*), without additional liability of its organs. However, in specific cases even an organ is personally liable for *culpa in contrahendo*. This could be the case if (1) the organ had a significant own economic interest in the transaction with the third party or (2) the organ made use of a special position of confidence in relation to the third party.[158] For the latter, it is however not sufficient that the organ had direct contact with the third party, as described in the alternative, but moreover a 'read my lips' type of attitude would be required. The extent of trust that is usually invested in negotiations must be exceeded significantly.[159]

23.2. Case Study (presenting false annual statements to third parties)

128 In the case of *intent*, D (both D1 and D2) would be liable based on the criminal offense of betrayal and/or based on intentional deceit. It makes no difference that D1 only acted in the background. The suborner is liable in the same way as the immediate offender[160] (see above no 126). By intentionally issuing the false balance sheets, D (D1 and D2) could also have committed the crime of unjustifiable representation of important information related to certain associations,[161] which is also a legal provision aiming to protect third parties who rely on the information and therefore provides a legal basis for damage claims.

129 In the case of mere *negligence*, D (D1 and D2) would be liable only under specific circumstances (on this, see above no 127).

23.3. Case Study (publishing an incorrect prospectus)

130 If the wrong information given to the auditor affected the prospectus, and if D acted *intentionally* regarding the correctness of the information, D would be liable for damages based on the criminal offense of incorrect representa-

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with the exception of a specific legal relationship between the representative and the third party. This can be based on § 874 ABGB *e contrario*, stating that third parties are only liable in cases of intentional deceit. To that, see also RIS-Justiz RS0016303.

158 See eg OGH 9.3.1994, 7 Ob 502/94; 13.3.1996, 5 Ob 506/96 and 29.10.1996, 4 Ob 2308/96g.

159 See OGH 15.7.1997, 1 Ob 182/97i.

160 On this, see § 12 StGB and § 1301 ABGB.

161 *Unvertretbare Darstellung wesentlicher Informationen über bestimmte Verbände*, see § 163a StGB.

tions in a prospectus,[162] and the criminal offense of betrayal or intentional deceit.

In the case of mere *negligence*, it might be doubtful whether D is liable to P. The OGH seems to hold the view that organs are not personally liable for incorrect representations in a prospectus.[163] 131

23.4. Case Study (violation of cartel law)

Under Austrian law, it is still *not clear* whether organs are personally liable for damage derived from violations of cartel law: in one decision (which only dealt with the issue of place of jurisdiction, however) the OGH supported such liability if the organ actively contributed to the infringement of cartel law or if an obligation to prevent the infringement was violated.[164] However, in another, more recent decision this issue was explicitly left open.[165] The case law regarding violations of competition law (see below no 133) seems to support the personal liability of organs also in the case of violations of cartel law. In the future, this issue may be decided by the CJEU based on the new directive on damages for infringements of competition law. 132

23.5. Case Study (infringement of competition law)

It is highly probable that D is *personally liable for the damage to P*: up to now, the OGH has only had to deal with injunctive reliefs, which were granted against the organ personally if the organ actively contributed to the infringement or the infringement was not prevented although the organ had knowledge of it or ought to have known of it. There seems to be no justification, however, for a different treatment of damage claims, as far as such claims can be based on the Austrian Unfair Competition Act.[166] This is undoubtedly the case for claims of harmed competitors. Therefore, P is entitled to claim damages from C-Corporation and from D. 133

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162 See § 15 of the Austrian Capital Markets Act *(Kapitalmarktgesetz,* KMG*)*. Despite this general title, this statute only deals with the prospectus which must be issued for public offers of securities and other investments and not with other issues of capital markets.

163 See OGH 15.3.2012, 6 Ob 28/12d.

164 See OGH 14.2.2012, 5 Ob 39/11p.

165 See OGH 16.6.2015, 4 Ob 95/15x.

166 *Gesetz gegen den unlauteren Wettbewerb, UWG*.

24. Company insolvency: liability of the board and its members towards the company's creditors

134 The directors – each one of them – are *personally responsible* for filing a petition for insolvency if the company is illiquid or overindebted[167] (see also above no 22). In the case of an at least negligent violation of this duty, all creditors of the company who suffered damage from this violation are entitled to claim damages from the director.

135 The extent of damages (the *calculation*) depends on the sort of creditor involved. The line is drawn between 'old' creditors,[168] who had already been creditors before the obligation to file for insolvency was violated, and 'new' creditors,[169] who became creditors only after the violation of this duty had already arisen:

136 *'Old' creditors* are entitled to claim the damages resulting from the decreased insolvency dividend of the obligation.[170] If and as long as insolvency proceedings regarding the company are pending, only the insolvency receiver is entitled to assert these claims,[171] thus safeguarding the interests of all creditors.

137 '*New' creditors* are entitled to claim their reliance interest:[172] they can demand to be put into the position they would have been in if they had not entered into the transaction with the insolvent company and therefore had not lost their (advance) performance to the company. This rule is also applied to persons who acquired shares of the insolvent company,[173] or to persons who provided collateral for debts of the insolvent company,[174] and for the social security agency regarding social security contributions which became due after the obligation to file for insolvency had been violated.[175] These claims may be asserted by the creditors during insolvency proceedings as well.[176]

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167 See § 69 IO.

168 In German: *Altgläubiger*.

169 In German: *Neugläubiger*.

170 In German: *Quotenschaden*. See eg OGH 23.2.1989, 7 Ob 726/88.

171 See § 69(5) IO.

172 In German: *Vertrauensschaden*. See eg OGH 12.7.2007, 2 Ob 241/06i.

173 See OGH 20.3.2007, 4 Ob 31/07y.

174 See OGH 11.10.2012, 2 Ob 117/12p. In this case, a guarantee was issued to a creditor of the insolvent company (registered association). The liability arising out of this guarantee was the relevant reliance interest.

175 See OGH 12.7.2007, 2 Ob 241/06i.

176 § 69(5) IO does not apply to these claims.

Apart from that, damages claims of creditors could arise if *criminal offenses* related to insolvency were committed.[177] 138

24.1. Case Study (delay in filing for insolvency)

In *case (a)*, P1 is an 'old' creditor as described above nos 135 and 136, because the loan had been granted before the obligation of D to file for insolvency started to exist. P1 can claim the difference between a quota of 20% and of 15%, ie 5% of € 1 million (= € 50,000). 139

In *case (b),* P2 is a 'new' creditor as described above nos 135 and 137, because the loan was granted at a time when D should already have filed a petition for insolvency. P2 can claim the whole loan (€ 1 million) as his reliance interest. 140

In *case (c)* the missed opportunity (the contract not concluded with X because P3 relied on the contract with the insolvent C-Corporation) is also an example for a relevant reliance interest which would have to be compensated if C-Corporation's insolvency (rather than other unrelated causes) was the reason for the non-performance of the contract. P3 could demand the decrease of the purchase price as compared to the missed contract with X (€ 400). 141

25. General duties owed by the board and its members towards creditors and liability for breach

Duties of the company to inform third parties may be a basis for personal liability of directors if (1) the directors intentionally violate the duty to inform (see above nos 126 and 128), or (2) the organ has a significant economic interest of its own in the transaction with the third party or makes use of a special position of confidence in relation to the third party (see above no 127), or (3) a legal provision explicitly imposes a duty to inform on the organ directly. An example for the latter is the duty of the directors of a tenant company to inform the landlord about facts that could justify an increase in rent.[178] 142

177 See § 156 to 163 StGB. OGH 21.4.2015, 3 Ob 29/15h, with regard to § 156 StGB (fraudulent bankruptcy – *Betrügerische Krida*); OGH 26.2.2003, 3 Ob 278/02g, with regard to § 158 StGB (fraudulent preference of a creditor – *Gläubigerbegünstigung*); OGH 15.1.2008, 10 Ob 96/07a, with regard to § 159 StGB (grossly negligent harm to creditors' interests – *Grob fahrlässige Beeinträchtigung von Gläubigerinteressen*).

178 See § 12a(3) of the Austrian Tenancy Act (*Mietrechtsgesetz, MRG*); OGH 20.1.2009, 4 Ob 220/08v, and 23.12.2014, 1 Ob 125/14k.

143 Furthermore, duties of the company *not to infringe legally protected rights* of third parties may be a basis for personal liability of directors if they contributed to the infringement or failed to prevent it (see above no 125). With respect to creditors, this could be relevant for the extinction of security rights (the creditor delivers goods to the company under retention of title, but due to intent or negligence of the director, despite the retention of title clause, title is passed because the goods are resold to a third party that acquires the title based on good faith, or because the goods are used in a finishing process[179]).

144 Finally, *criminal offenses* related to insolvency could be a legal basis for personal liability of directors to creditors of the company (see also above no 138).

25.1. Case Study (personal liability for delay in filing financial statements)

145 The directors of a company are obliged to publish the annual accounts within a period of nine months after the end of the accounting year.[180] If they fail to do so, penalty payments may be imposed on them.[181] However, up to now there has been *no case law supporting civil liability towards creditors*. It does not seem impossible, nonetheless, that Austrian courts could grant damages in such a case. The issue is whether the legal provisions on the disclosure of annual accounts are deemed to be legal provisions that aim to protect the company's business partners or creditors (on this, see also above no 124).

146 Depending on the facts of the case, it would be possible that personal liability of D is supported by other reasons as well, for example *betrayal or intentional deceit* committed by the omission to warn P about the bad economic state of C-Corporation.

26. Direct liability of the board and its members towards creditors

147 A breach of duties to the company cannot be a basis for legal claims of the company's creditors. The duties owed to the company do not have the aim of protecting the company's business partners or creditors. Direct claims would only be possible if the breach of duties to the company also met the requirements of a tort claim of a third party (see above no 124).

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179 On such cases, see German Federal Court (*Bundesgerichtshof*), 5.12.1989 – VI ZR 335/88 and 12.3.1996 – VI ZR 90/95.

180 See § 277 UGB.

181 On this, see § 283 UGB.

27. Limiting the liability of the board and its members towards third parties

Third parties are not affected by the internal documents or resolutions of the company: contracts at the expense of a third party are not recognized under Austrian law. 148

27.1. Case Study (limitation of liability)

It is *not possible* to limit or exclude a director's liability vis-à-vis third parties in internal documents or acts of the company, see above no 148. 149

On the impossibility of limiting or excluding the liability vis-à-vis the company, see above nos 78, 79 and 82. 150

IV. Procedural Law Aspects

28. Persons and corporate organs can be parties to a suit for damages

Under Austrian procedural law, only individual persons (natural persons or legal entities) can be parties to a suit for damages. Organs of a corporation do not have legal personality or any legal capacity, so they cannot be parties in civil litigation.[182] 151

Therefore, only *individual directors*, individual *members of the supervisory board* and individual *shareholders* can be parties in such proceedings. It is also possible to raise a claim against all directors or all members of a board in the same litigation. 152

The *corporation* itself can also be a party in such proceedings if it has legal personality or at least legal capacity, which is the case for all companies with the exception of the civil law association (see above no 6). 153

182 As far as can be seen, this issue has not been discussed on a broad basis in Austrian legal literature up to now. *C Koller/O Riss*, RdW 2013, 64 fn 23 at least drew attention to the issue. For Germany, see eg *Werth* in: H-J Musielak/W Voit, Zivilprozessordnung: ZPO (14th edn 2017) § 50 no 19 of the German Civil Procedure Code, with further refs. Even if the capacity of organs to be party in civil litigation in general, eg for an action for injunction, were recognized (*quod non!*), it seems impossible that Austrian courts could decide in the same way for damage claims: liability is attributed to individual persons, and not to a group of persons even if they acted collectively. So each member of the organ is to be sued individually, notwithstanding the possibility that the proceedings could be combined.

29. Standing and requirements to sue for damages against the board

154 For *claims against directors* (*Vorstand* of a stock corporation or *Geschäftsführer* of a limited liability company) who are still holding this position, the company is represented by the *supervisory board*. It is not clear whether the same applies to claims against former directors, or if in this case the newly installed directors represent the company.[183] To avoid any uncertainty, the members of both organs should issue the power of attorney to the lawyer representing the company and both organs should be mentioned in the statement of claims.

155 For *claims against members of the supervisory board*, the company is represented by the directors.

156 In the alternative, specific representatives may be appointed by the shareholders' meeting or by the competent court to represent the company in such lawsuits.

157 In the case of a *limited liability company*, a resolution of the shareholders approving the lawsuit against organs is required.[184] If this requirement is not met (and an objection is raised by the organ before the court of first instance), the claim will be dismissed. However, a resolution is not necessary for claims raised by minority shareholders (see below no 159), by the insolvency receiver or distraint remedies exercised by creditors in the course of compulsory enforcement against the company.

158 In the case of a *stock corporation*, it is not clear if and when a shareholders' resolution is required to legitimate a lawsuit against organs. The more convincing arguments support the position that in any case the competent administrative organs (see above nos 154 and 155) are free to file a lawsuit without the shareholders' consent. On the other hand, if the shareholders pass a resolution demanding that a claim shall be raised, then the administrative organs (or the appointed representatives, see above no 156) are bound to do so.[185]

159 *Minority shareholders* of a *limited liability company* are entitled to raise the claim themselves after the shareholders have refused to approve a claim; in this case, the minority shareholders act on their own behalf, but on the account of the company, ie with the requirement that the funds shall be transferred to the company.[186]

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183 See eg AktG/*Kalss* (fn 112) § 97 no 21, and *Koppensteiner/Rüffler* (fn 106) § 30l no 3, both with further refs.

184 See § 35(1) no 6 GmbHG.

185 See § 134 AktG.

186 On this, see § 48 GmbHG.

Minority shareholders of a *stock corporation* are not entitled to raise a claim themselves, but only to demand that a claim shall be raised by the corporation under the condition that the claims are not obviously without merit.[187] **160**

30. Legal representatives and conflicts of interests

From a formal point of view, the company and not the members of the board was the lawyer's client. Therefore, the lawyer will not be prevented from representing the company in a suit against the members of the board. On the other hand, if the lawyer (or the respective law firm) also has personal mandates for the organ (eg a divorce or the challenge of a speeding ticket), there is a relevant conflict of interest so that the lawyer is not allowed to represent the company against the organ.[188] **161**

In the second case, the lawyer is not allowed to act on behalf of the organs in a suit against the company. **162**

31. Pursuing damages against the board and its members: procedural rules and competent court

There are *no special procedural rules* for such claims in Austrian law. **163**

The *commercial court* is competent for claims against directors or members of the supervisory board.[189] However, if the organ was an employee or its contractual relationship to the company could be considered 'employee-like', which might be the case for a director of a limited liability company without a shareholding in the company or without a significant shareholding, and – exceptionally – also for a director of a stock corporation,[190] the labor court could be competent instead. In these cases, the jurisdiction of the labor court takes **164**

187 See § 134 AktG.

188 For the relevant legal framework on conflicts of interest, see § 10 ff of the Guidelines for practice of the profession of lawyer (*Richtlinien für die Ausübung des Rechtsanwaltsberufes* – RL-BA 2015).

189 See § 51(1) nos 6 and 7 of the Austrian Statute on Jurisdiction *(Jurisdiktionsnorm,* JN*)*.

190 Directors of a stock corporation are not employees under Austrian law, instead their relationship to the corporation is classified as a 'free' services contract (*freier Dienstvertrag*) to which many mandatory provisions of labor law do not apply. For the exceptional classification of a director of a stock corporation as 'employee-like' see OGH 29.5.1996, 9 ObA 2044/96w and 29.3.2006, 9 ObA 75/05b.

precedence over the commercial court's jurisdiction.[191] Prorogation of jurisdiction (*ratione materiae*) is not possible in labor and social law matters.[192]

V. Insurance Law Aspects

32. General statutory and non-statutory rules regulating D&O insurance

165 In Austrian law, there are no general rules relating to D&O insurance. The Austrian Insurance Contracts Act[193] does not specifically deal with this type of insurance, and neither do the statutes in the field of company law. However, the general legal rules regarding insurance contracts and certain types of insurance contracts may apply, in particular those related to liability insurance.[194] The common type of D&O insurance concluded by the company, which may also be the party to whom the insured persons are liable (see below nos 173 and 177) differs in some respects from normal liability insurance; the legal provisions for insurance on the account of a third party[195] are applicable to this type of insurance. Furthermore, D&O insurance may also contain elements of legal protection insurance (see below nos 188 and 193).

166 Likewise, the Austrian Code of Corporate Governance[196] contains no rules specifically relating to D&O insurance.

167 Up to now, there has been almost no Austrian case law relating to D&O insurance. Only one decision of the OGH rendered at the end of the year 2015 specifically deals with this type of insurance.[197] It is rather probable, however, that further cases could be brought to the OGH in the near future.

168 Nevertheless, both the Austrian Stock Corporation Act[198] and the Austrian Code of Corporate Governance[199] mention insurance premiums (in general, without a specific reference to D&O insurance) in the context of remuneration. According to said provisions, the supervisory board shall ensure that the total remuneration is commensurate with the tasks and performance of each individual

191 See § 51(1) no 6 JN.

192 See § 9(1) of the Austrian Labor and Social Courts Act *(Arbeits- und Sozialgerichtsgesetz)*.

193 *Versicherungsvertragsgesetz*, VersVG.

194 See §§ 149–158a VersVG.

195 In German: *Versicherung für fremde Rechnung*. See §§ 74–80 VersVG.

196 As amended in January 2015.

197 See OGH 19.11.2015, 7 Ob 137/15w.

198 § 78.

199 Rule 26a of the Austrian Code of Corporate Governance, which is defined as an 'L' (= legal) rule.

member of the management board, the situation of the company, as well as the usual level of remuneration, and must also take measures to create long-term incentives for sustainable corporate development. On the issue of whether D&O insurance premiums are also part of the organs' remuneration, see below no 175.

169 There are *no template general conditions* for D&O insurance issued by the Austrian Association of Insurers either, but every insurer uses its own general conditions. The general conditions used by individual insurers differ significantly. Furthermore, several foreign insurers offer D&O insurances on the Austrian market. In these cases, the home-made general conditions (eg conditions which are based on German law) are used without any or at least without any significant adaptation for Austria.

170 Unlike in German law, where such a requirement was established by an amendment to the Stock Corporation Act in the year 2009,[200] a *deductible* is not legally obligatory in Austria. Likewise, the Austrian Code of Corporate Governance does not deal with this issue. Some legal scholars take the position that the necessity to provide for a deductible can be derived from general principles of Austrian corporate law, based on the argument that insurance without a deductible would undermine the preventive function of liability for damages.[201] However, this does not seem to be the prevailing opinion.[202]

171 Therefore, the company is free to decide whether the insurance contract shall provide for a deductible. As far as can be seen, deductibles do not seem to be common in Austria. If a deductible is agreed on in the insurance contract, a director or officer is not hindered from taking out *extra insurance cover to bear the deductible* in a separate insurance contract and at his own expense. This is also the prevailing opinion in German law, which provides for obligatory deductibles in insurance contracts concluded by the company.

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200 § 93(2) 3rd sent of the German Stock Corporation Act.

201 See *P Doralt/W Doralt* in: P Apathy/R Bollenberger/P Bydlinski/G Iro/E Karner/M Karollus (eds), Festschrift für Helmut Koziol (2010) 582, who at least seem to tend towards this position; *S Kalss* in: Münchener Kommentar zum Aktiengesetz (hereinafter MünchKomm AktG), vol 2 (4th edn 2014) § 93 no 388; *M Gruber*, Zeitschrift für Gesellschaftsrecht (GesRZ) 2012, 93 ff.

202 See *C Nowotny* in: P Doralt/S Kalss/C Nowotny, Kommentar zum Aktiengesetz (2nd edn 2012) § 84 no 32; *U Torggler* in: E Artmann/F Rüffler/U Torggler (eds), Die Organhaftung zwischen Ermessensentscheidung und Haftungsfalle (2013) 52; *T Wenger/S Adrian*, Zeitschrift für Recht und Rechnungswesen (RWZ) 2015, article no 83, with further refs.

33. D&O policies: parties, corporate representatives and the treatment of premiums

172 In the absence of any specific legal rules relating to D&O insurance (see above no 165), the *parties are free to decide* on the design of the insurance contract.

173 The common version of D&O insurance is a type where the company is the insurance holder (the contractual partner of the insurer) whereas the organs are the insured persons (insurance on the account of a third party; see above no 165). The insurance contract is concluded by the company only, whereas the consent of the organs (the insured persons) is not required.[203] The insurance premiums are paid by the company.

174 Whether these premiums are deductible from the remuneration of the organs is an issue of the contractual relationship between the company and the organ. As far as is known, such a deduction is not common in Austria. The remuneration of the organs is not linked to insurance premiums which are separately paid to the insurer by the company, without being reimbursed for that in any way.

175 The issue of who is authorized to represent the company in concluding the insurance contract as described above no 173, is highly disputed in Austria. Due to the unlimited power of attorney of the directors (*Vorstand* in a stock corporation or *Geschäftsführer* in a limited liability company), they have the legal power to validly conclude the D&O insurance contract on behalf of the company. The question is, however, whether the directors need the consent of another organ to conclude the insurance contract. Some scholars[204] take the view that such an insurance is part of the organ's remuneration, thus leading to the consequence that the organs who are competent to decide on another organ's remuneration are also competent to decide on the conclusion of D&O insurance (ie in a stock corporation the supervisory board with respect to D&O insurance for directors, the shareholders' meeting with respect to such insurance for members of the supervisory board, and in a limited liability company the shareholders in both cases if directors' remuneration issues have not been transferred to the supervisory board by the articles of association as would be possible under Austrian law). Other scholars,[205] however, contest the nature of insurance premiums as

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203 See eg OGH 9.5.2012, 7 Ob 67/12x (on insurance on the account of a third party in general).

204 See eg *M Ramharter* in: S Kalss/P Kunz (eds), Handbuch für den Aufsichtsrat (2nd edn 2016) 1122–1126; MünchKomm AktG/*Kalss* (fn 201) § 93 no 388; *Torggler* (fn 202) 52–57 and *Wenger/Adrian*, RWZ 2015, article no 83, with further refs.

205 See eg *M Gruber/T Wax*, wirtschaftsrechtliche Blätter (wbl) 2010, 169 ff.

being part of the remuneration, mainly by drawing attention to the aspect that the company itself draws the predominant profit from D&O insurance because the chances that effective compensation can be received, even if huge damages claims are at stake, are significantly increased by the insurer as an additional solvent debtor; furthermore, D&O insurance is understood as being a measure related to the organs' working environment, as, for example, a bodyguard who may also be paid for by the company independent from remuneration. According to this position, the directors would be authorized to conclude the insurance contract on behalf of the company. One decision of the OGH seems to support the former position.[206] However, said decision apparently did not deal with classical D&O insurance, but rather with some sort of legal protection insurance,[207] so the relevance of this decision for D&O insurance may be contested. Furthermore, § 78 of the Austrian Stock Corporation Act and Rule 26a of the Austrian Code of Corporate Governance (see above no 168) also seem to support the position that D&O insurance policies with the premiums being paid by the company are part of the organs' remuneration. Until a clear statement by the OGH (or by the Austrian legislator) is issued, the legal situation is unclear.

176 Some Austrian insurers also offer *'individual' D&O insurance*, where the organ is not only the insured person but also the insurance holder (the contractual partner of the insurer). This type of D&O insurance avoids the problems resulting from the 'hybrid' character of classical D&O insurance as described above no 173 and the uncertainties with respect to the authorization to conclude the insurance contract for the company as described above no 175. The advantage from the organs' perspective is that it is up to them to conclude the insurance the way they want. The major disadvantage is that the organs are obliged to pay the insurance premiums themselves. As far as can be seen, this type of D&O insurance is far less common than the type with the company as the insurance holder.

34. Insured persons

177 In the common type of D&O insurance, the organs are the insured persons (see above no 173): they are insured against the risk of being liable for damages to the company and/or to third parties. The organs' benefit is that the insurer grants assistance in defence against claims and liberation from damage liabili-

206 OGH 30.6.1999, 9 ObA 68/99m.

207 In the German original: *Erweiterte Rechtsschutzversicherung für Manager*. However, the concrete content of the insurance are not described in the decision.

ties if such liabilities exist. On the other hand, the company draws benefit from the insurance by receiving the damages payments out of it (if such a claim is successfully proven by the company, see also below no 183), thus being compensated even if the state of solvency of the organs would not have enabled them to perform payments in this dimension (see above no 175).

178 It is possible to insure a *group of persons* (either named or generally described by their functions) in one comprehensive insurance contract. It seems to be usual in Austria to conclude D&O insurance this way, instead of single contracts for individual organs.

179 It is also possible to insure *organs and senior employees of a subsidiary* or an affiliate company. Such 'group' insurance seems to be common in Austria.

35. Standing to claim under a D&O policy

180 In the usual D&O insurance concluded by the company as the holder of the insurance (see above no 173), which is thus insurance on the account of a third party (the insured persons), the legal provisions on this type of insurance are applicable. According to these provisions, the rights emanating from the insurance contract are (materially) attributed to the insured persons.[208] On the other hand, only the company can demand the issuance of the certificate of insurance.[209] Therefore, only the *company can claim for performance and bring an action requiring cover if the insurer refuses coverage*.[210] In this case, the company as the formally entitled party acts in the interest of the insured persons (its organs) in a manner which is regarded as being a type of trusteeship.[211] The organs can raise such a claim only (1) if they are in possession of the certificate of insurance, (2) with the consent of the company, (3) if the company does not intend to assert its claim[212] or (4) if such a right is granted in the insurance contract, which is often the case in D&O insurance. The right may be granted exclusively to the organs, or in addition to the right of the company.

181 *Third parties* to whom the organ is liable have no right to assert a direct claim against the insurer for payments.

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208 § 75(1) 1st sent VersVG.

209 § 75(1) 2nd sent VersVG.

210 § 76(1) VersVG.

211 See eg OGH 9.5.2012, 7 Ob 67/12x (on insurance on the account of a third party in general).

212 See eg OGH 10.5.2006, 7 Ob 260/05v (on insurance on the account of a third party in general).

182 In a case where the company is the injured person to whom the organ is liable, basically the same applies to the company in this role. However, due to the fact that the company is also the holder of the insurance, the company can demand that insurance coverage is granted (see above no 180), including the insured persons' right to be liberated from damage claims; if these claims may be exercised by the company based on its formal ownership of these rights as described above no 180[213] or if they are validly assigned to the company, that could result in a direct damages claim of the company against the insurer by transformation of a claim for being liberated from liability (*Befreiungsanspruch*) into a pecuniary claim. This claim would become due when the triggering event for such payments, eg a court ruling ordering the organ to pay damages, takes place.[214] According to some general conditions, a direct claim of the company is already granted on a contractual basis.[215]

183 D&O *insurers are very reluctant* to release payments without a court ruling on damages claims, even if the facts of the liability case seem to be clear.[216] One apparent reason for this is the fear that the company and the organ could collusively try to cover the company's losses out of the insurance by creating a fake case of organ's liability. Therefore, it is often necessary to at least start the proceedings on the damages claim. Sometimes, a settlement may be agreed on during the proceedings. In the worst case, two different proceedings are necessary (between the company – or the organ – and the insurer for insurance cover, and between the company and the organ with regard to the damages claims).

35.1. Case Study (claims for performance by the company)

184 As stated above no 180, the *company may in all cases claim performance* under the policy in the sense that insurance coverage can be demanded; the only exception is that these rights have been transferred to the insured persons (the organs) exclusively in the insurance contract (the general conditions). As a consequence of the legal structure of insurance on the account of a third party

213 The holder of the insurance is entitled to exercise all rights deriving from the insurance contract vis-à-vis the insurer, irrespective of his internal relationship to the insured person. See eg OGH 9.5.2012, 7 Ob 67/12x (on insurance on the account of a third party in general).

214 See *I Welser/M Siegwart* in: P Lewisch (ed), Jahrbuch Wirtschaftsstrafrecht und Organverantwortlichkeit (2013) 332, drawing attention to the issue that many general conditions contain a prohibition of assignment.

215 See *I Welser/Siegwart* (fn 214) 332 f.

216 See *I Welser/Siegwart* (fn 214) 328 f.

(and at least if these claims have been assigned to the company or if a direct claim of the company is provided for in the insurance contract), the company could also claim for direct payments (see above no 182).

185 The legal assessment is not changed by the fact that D goes into hiding or becomes bankrupt. These cases could only create problems in the case that the rights emanating from the insurance contract are exclusively attributed to the organs (see above no 180). If no insolvency proceedings are pending over D, the company could try to seize D's contractual rights in execution proceedings, which would require an enforceable court ruling on the damage claims.

35.2. Case Study (claims for performance by third parties)

186 P has no right to claim performance from I-Insurance (see above no 181). The lack of a legal relationship with C-Corporation or the bankruptcy of C do not change this legal assessment.

36. Definition and occurrence of the insured event: D&O vs legal protection insurance

187 In the classical type of D&O insurance, the event insured is that an *organ of the company is liable* for damages (a) to the company and/or (b) to third parties. The insurer commits itself to liberate the organ from its liability by paying the damages, up to the sum insured. Very often, the payment obligations of the insurer are additionally limited by a serial loss clause, meaning that damages which are based on the same or a similar violation of duties are treated as one single insured event.[217] Such a clause involves advantages and disadvantages both for the insurer and for the insured person.[218]

188 Usually the insurer also undertakes to *support the organ as soon as a damages claim is raised* (or even before claims are actually raised, as soon as it becomes probable that claims could be raised in the future), for example by funding the defence of the organ in the proceedings or by paying a lawyer to protect the organ's interests even before a claim is raised. In this respect, the D&O insurance also contains elements of legal protection insurance. According to typical general conditions, also when the company defends itself against the

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217 In German: *Serienschadenklausel*, on such a clause, see OGH 9.7.2014, 7 Ob 70/14s and 19.11.2015, 7 Ob 137/15w. The latter decision dealt with D&O insurance.

218 See OGH 19.11.2015, 7 Ob 137/15w.

organ's remuneration claim by demanding a set-off with its damages claims is covered, thus leading to the result that the insurer is obliged to assist the organ in the proceedings on the remuneration claim.[219]

189 D&O insurance is usually based on the *'claims made' principle*,[220] meaning that the point of time when the claims are raised (and not when the acts or omissions leading to the damages were committed) is decisive for insurance coverage: in order to be covered by the insurance, the relevant claims must be raised during the duration of the insurance (including an extended discovery period[221]), even if the relevant acts or omissions had been committed before this period started or even before the insurance contract was concluded (retroactive insurance[222]).[223] Vice versa this means that there is no coverage for acts or omissions committed within this period if the claims are raised after the end of the insurance period and an extended discovery period. However, according to some general conditions, it is possible to inform the insurer about certain circumstances which could lead to damages claims in the future within the defined periods.[224] In this case, also damages claims which are raised after these periods are covered by the insurance.

190 In this respect, it must be taken into account how *limitation* works under Austrian law, ie that the limitation period only starts to run when the damaged person has become aware of the damage and of the person which is liable for it (above no 65). Therefore, it is vital for the organs and for the company to insist on a sufficient *extended discovery period* (even five years as provided for in some general conditions can be too short) or to make sure that, if an insurance contract is terminated, renewed follow up insurance coverage is secured, also including acts or omissions committed before the conclusion of this insurance contract and – ideally – also including former organs as insured persons. In the

219 For such a case, see OGH 19.11.2015, 7 Ob 137/15w.

220 On this, see also OGH 19.11.2015, 7 Ob 137/15w.

221 In German often named *Nachmeldungsfrist* or *Nachhaftungsfrist*.

222 In German: *Rückwärtsversicherung*.

223 However, some general conditions state that only damages from acts or omissions which were committed during the duration of the insurance are covered; thus, retroactive insurance is excluded (or included only in the case of an additional agreement, with an additional insurance premium to be paid for that) either generally or at least in certain cases (subsidiaries which are acquired during the insurance period). Furthermore, several insurers exclude coverage for breaches of duty committed before conclusion of the insurance contract (or in the case of its renewal) if they were known by the insured person (or by the insurance holder, ie certain persons whose knowledge is attributed to the company) at the time of conclusion or of the renewal. On this, see also below no 215.

224 In German often called: *Umstandsmeldung*.

case of a new insurance contract being concluded, problems could arise in connection with subsidiary clauses stating that events covered by another insurance contract are not covered by the current insurance contract. Furthermore, it is necessary to investigate the general conditions with regard to the termination of an organ's appointment, ie whether that leads to an immediate termination of insurance with respect to this insured person.

191 In classical *legal protection insurance*, the insured events are not defined by the 'claims made' principle, but by the triggering events for liability. Therefore, it is not relevant for insurance coverage when the claims were raised, but only when the acts or omissions leading to a damage claim were committed.

192 Claims that are raised against the company by shareholders or third parties are not covered by the classical D&O insurance which is focussed on the organs' liability to the company or to third parties, and not on the company's risks of being liable to a third party itself. Those risks may be insured by an *'entity cover' insurance*. Therefore, a claim letter received by the company does not constitute 'claim made' in the sense of D&O insurance. However, if the D&O insurance also includes preventive measures of defence against claims which could probably be raised in the future (see above no 188), such a claim letter directed to the company may also be a triggering event for preventive defence measures related to the organs if the contents of the claim letter make it seem likely that the company and/or the third party may also raise claims against the organs. Furthermore, such a letter may make it possible to inform the insurer about a prospective claim within the defined periods for such a notice with the effect that these time-limits are fulfilled if the claim is actually raised later on (see above no 189).

36.1. Case Study (costs of defending a director against a claim by the company)

193 If the D&O insurance also includes the legal protection element as described above no 188, which seems to be common also in Austria, the costs of defence against asserted claims of the company which pays the insurance premiums are also included in the coverage by the D&O insurance policy. It must be admitted that this result, leading to the effect that the *defence against the company's claims is indirectly funded by the company itself* seems awkward at first sight, but this is simply the logical consequence of the hybrid nature of insurance which is concluded by the company for the benefit of its organs who are the insured persons, when the insurance also covers the organs' liability to the company as an insured event.

37. Scope of D&O coverage and the insurer's obligations: D&O vs legal protection insurance

D&O insurance usually obliges the insurer to *release the insured organ from claims of the company and/or third parties*, until the amount covered by insurance is reached. Furthermore, legal protection against such claims, including the costs for legal defence as soon as a claim is raised (or even before claims are actually raised, for instance as soon as it becomes probable that claims could be raised in the future), is usually covered by D&O insurance (see above no 188). **194**

Direct coverage as described above does not seem to be common in Austria. Some insurers offer D&O insurance including *corporate reimbursement*,[225] ie so that the company is reimbursed by the insurer if it has liberated insured persons from their liabilities, and *securities entity coverage*, ie so that in cases where claims are raised against the company and insured persons out of dealings in securities, the insurer will reimburse 100% of the claims, without this being divided between the company and the organs, or in the sense that the company is reimbursed even in cases where only claims against the company are raised. **195**

Most D&O insurance contracts provide for advance payments (*interim cover*) in cases when it is not clear whether an event triggering an exclusion from insurance coverage has occurred (see also below no 217). **196**

Depending on the individual general conditions, a *duty of the insurer to defend* as described may be provided for. If the insurer has the right to act in litigation on behalf of the insured person (see below no 210), that necessarily implies that it is up to the insurer to work on the defence strategy if these issues are not completely left to the lawyer representing the organ in the proceedings. In any case, it is in the best interest of the insurer that a claim is repelled as far as possible. As for the right of the insurer to make all declarations on behalf of the insured person that are deemed necessary to settle the dispute and to act in litigation on behalf of the insured person which is usually provided for in the general conditions, see also below no 210. **197**

The right of the individual insured persons to *choose their own lawyer* is often limited in the general conditions of D&O insurance, eg by a right of refusal on the part of the insurer for important reasons (or even without a need for justification). In legal protection insurance, it is not possible to restrict the right of free choice of the legal representative.[226] Although D&O insurance also contains **198**

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225 In German: *Firmenenthaftung*.

226 See § 158k VersVG (with the only exception that restrictions regarding the lawyer's seat are admissible). See also European Court of Justice (CJEU) 10.9.2009, C-199/08, *Eschig v UNIQA Sachversicherung AG*, ECLI:EU:C:2009:538.

certain elements of legal protection insurance, it does not seem to be justified to adopt the same principles also for D&O insurance (or for liability insurance in general) because in these cases the insurer has a vital interest in the outcome of the proceedings too, and not only in controlling the costs of legal representation. Therefore, it is to be assumed that said clauses are lawful, at least in the case that the insurer has good reasons to object to the insured person's choice of lawyer. Moreover, it could be argued that a right of refusal for good cause must remain possible in any case.

37.1. Case Study (advance payments for legal defence)

199 (a) und (b) constitute an insured event according to the typical conditions of a D&O insurance policy; for (c) this is only the case if legal protection in criminal cases is also included in the insurance, which may be the case either generally or at least in cases where damages claims are already asserted in the criminal proceedings or could be a consequence of the outcome of the criminal proceedings.

200 According to the typical conditions of a D&O insurance policy, D has the right to be paid *compensation for the costs of his legal representation* in the lawsuit which is covered by the insurance (see above no 188). In this case, the insurer is obliged to cover D's costs *before the lawsuit is finally terminated*. Apart from legal representation, the costs for experts or even for a *public relations manager* or a *psychiatrist* may also be covered.

201 Usually, legal costs are also limited by the amount of insurance cover, meaning that these costs and the damages payments are added up. In some cases, there are also extra limits ('sublimits') for legal costs.

37.2. Case Study (reimbursement and compensation for fines and imprisonment)

202 Provided that the D&O insurance also covers criminal proceedings (see above no 199), and that no exclusion of coverage for intentional breaches has been agreed on (on this, see below nos 213 and 214), D may claim payments covering his *legal costs* in both cases.

203 Compensation for *fines* is usually not granted. An agreement providing for such compensation would very probably be regarded as a violation of the basic principles of Austrian law and therefore would not be valid.

37.3. Case Study (pure economic loss/mass claims)

In the case of *negligence* (as opposed to intent), it is not clear whether D would be liable to the investors under Austrian law (see above nos 127 and 129). Only if the *criminal offense* of § 163a StGB, of fraud (§ 146 StGB) or – in the case of a prospectus – of § 15 KMG or wilful deceit (§ 874 ABGB) was committed, which would (at least)[227] require intent regarding the incorrectness of the information, would D certainly be liable to the investors (see above nos 124, 126 and 128). **204**

If there is no liability for negligence, there is no need to determine the relevant standard of negligence. **205**

As far as D is liable to investors, and if security claims are not excluded from insurance coverage (see also above no 195 and below no 213), D may seek to be released from the investors' claims and for his legal costs to be borne by the insurer. **206**

38. Duties of D&O policyholders and insurers' right to participate in the claims handling process

Typical general policy conditions state (a) certain *pre-contractual duties*,[228] for example, the duty to inform the insurer about all circumstances that are relevant for its decision to assume the risk,[229] and (b) duties that apply *during the duration of the contract*, like the obligation to inform the insurer about risk-increasing circumstances[230] (which are sometimes enumerated conclusively in the general conditions). **207**

Furthermore, typical general conditions oblige the insurance holder (the company) and the insured persons (the organs) to *inform the insurer promptly*[231] *about the occurrence of the insured event*,[232] which means that claims are at least asserted against the organ. Some general conditions also give the insured person the right to demand *pre-emptive assistance* in cases where certain circumstances make it likely that claims against the organ may be asserted in the fu- **208**

227 In the case of fraud, also intent to deceive, to cause damage to the deceived person, and of unjust enrichment is required.

228 See also §§ 16–22 VersVG.

229 Sometimes a questionnaire has to be answered by the applicants for insurance, with the consequence that all topics mentioned therein are deemed to be relevant in this sense.

230 See also § 23 VersVG.

231 In German: *unverzüglich*.

232 In German: *Versicherungsfall*.

ture, or explicitly define this as an additional insured event (see above nos 188, 189 and 192), which means that the duty to inform the insurer promptly applies as well.

209 In addition, the insured persons usually have the duty to *provide the insurer with all necessary information*, to assist the insurer and to mitigate damage.

210 According to typical general conditions, the insurer has the right to make all declarations on behalf of the insured person that are deemed necessary to *settle the dispute and to act in litigation on behalf of the insured person*.[233] However, the insurer is only entitled to agree on a settlement without the consent of the insured person as far as the amount insured is sufficient to fulfil the obligations resulting from the settlement.

211 Some general conditions state that if the insured person objects to a settlement, the insurer will not be liable to the extent that the court later on grants higher damages.

212 The legal consequence of the violation of a pre-contractual duty may be a right of the insurer to rescind the insurance contract; instead of that, some general conditions grant the insurer a release from obligation, as far as damage claims are based on circumstances that were not disclosed to the insurer. In the case of contractual duties, the legal consequence may be a release of the insurer from its obligation to perform. However, if the violation of a duty to inform the insurer was not relevant at all for the insured event, the obligation of the insurer to perform is not affected.[234]

39. Typical exclusions from coverage in D&O policies

213 Typically *deliberate or conscious breaches of duty* are excluded from insurance coverage; sometimes, this is specified in the way that only a conscious breach of 'legal' duties shall be relevant. The same applies to *criminal offenses*. Furthermore, *'North America' risks* (related to liability to the company) or risks related to *securities* are often restricted. According to some general conditions, insurance cover ends in the case of a *change of control*.[235] Further exclusions may be agreed on based on an analysis of the risks of the given case.

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233 According to the general conditions of some insurers, the insured person is at first entitled to act in litigation, however the insurer has the right (a) to give directives, and (b) to take over the conduct of litigation.

234 See OGH 19.11.2015, 7 Ob 137/15w.

235 On this, see OGH 19.11.2015, 7 Ob 137/15w.

An exclusion from insurance in cases of 'deliberate or conscious breaches of duty' means that, in deviation from § 152 VersVG, only the breach of duty and not the damage resulting thereof must be intentional in order to trigger an exclusion event, thus leading to a very broad potential scope of application of the exclusion. According to the case law of the OGH, such a clause is valid.[236] 214

Furthermore, most general conditions exclude coverage for breaches that the insured person and/or the company were aware of at the time of conclusion of the insurance contract, or at the time of renewal of the contract. The same applies to breaches which are *covered by another (former) D&O insurance* contract, even if the insurance amount of this other insurance is not sufficient for said damages claims. In these cases, the retroactive insurance (see above no 189) is excluded, thus making it difficult to cover all risks from the past by concluding a follow up insurance contract or by its renewal (see above no 190). 215

Finally, many general conditions exclude *first party losses*: insurance coverage is denied if the insured person holds a significant stake in the company to which the insured person is liable. 216

At the time when claims are raised, it is often not clear whether an event triggering an exclusion from insurance coverage has occurred. In these cases, in most D&O insurance contracts *interim cover* is granted. If it is ascertained later on that the prerequisites for an exclusion from coverage are fulfilled, the insured persons are obliged to refund the granted benefits. However, some insurers waive their right to reclaim costs of defence either generally or in specified cases. 217

In principle, it would not be against the law to insure *intentional or even criminal acts*. However, in the latter case only the costs of legal defence or civil law damages can be covered by the insurance, whereas compensation for *fines* is deemed to be unlawful (see also above no 203). 218

40. Claim for determining the insurance coverage

Usually an action for an insurance coverage related declaratory judgment will be *filed by the company* which is in this case acting in the interest of the organs (the insured persons) who are the material owners of these rights (see above no 180). It is therefore not necessary to define the insurance agreement (the general conditions) in this way to reach this result. 219

236 See eg OGH 26.5.2004, 7 Ob 83/04p.

220 Moreover, it is common that the insurance agreement (the general conditions) also – or even exclusively – *grants this right to the insured persons* (the organs; see above no 180).

41. Differences between the legal position of the board or director

41.1. Case Study (comparison of D&O insurance vs exclusion of liability)

221 Alternative (b) is not possible under Austrian law (see above nos 78, 79 and 82).

222 It must be stressed, however, that the *company's position is completely different* in the two cases: in the first case (a), the company receives compensation for the damage it suffered (from the insurer); from an economic point of view, the insurance premiums must be deducted from this benefit. In the second case (b), the company receives no compensation and has to bear the damages on its own.

C Portugal Gouvêa and M Pargendler

Directors' and Officers' Liability in Brazil

I. General Part – Overview of the Corporate Law Framework

1. Nature of and distinction between various types of companies

Brazilian law provides for the following organizational forms for business firms: I – *sociedade anônima* or *companhia* (corporation), which may be private (*companhia fechada*) or public (*companhia aberta*); II – *sociedade limitada* (limited liability company), which is always private in the sense that its equity interests may not be publicly issued and traded; III – *sociedade em comandita simples* (limited partnership); IV – *sociedade em comandita por ações* (limited partnership by shares); V – *sociedade em nome coletivo* (general partnership); VI – *sociedade simples* (partnership); VII – *sociedade em conta de participação* (partnership without legal personality in which one partner is apparent and another is hidden); and VIII – *sociedade em comum* (partnership without legal personality). These legal forms are *numerus clausus* under Brazilian law. 1

Corporations and *limited liability companies* are the most widely used company forms. The legal form *sociedade simples* is mostly used for partnerships in liberal professions. The remaining legal forms are not commonly used in Brazil. Therefore, the analysis in this chapter will be limited to corporations and limited liability companies. 2

Law 6,404 of 15 December 1976 (*Lei das Sociedades por Ações*, hereinafter LSA) contemplates certain differences as to the legal regime and *governance structure* applicable to *private and public corporations*. Although the fiduciary duties applicable to public and private corporations are generally the same, certain duties concerning the disclosure of material information to the public only apply to public corporations. Moreover, only public corporations are subject to the regulations and oversight by Brazil's Securities Commission (*Comissão de Valores Mobiliários* – CVM), which may impinge on the specification and enforcement of directors' fiduciary duties. 3

There is, however, a fundamental distinction in terms of the *liability regime* applicable to private and public companies. Directors and officers in private companies are jointly and severally liable for damage caused in breach of the duties imposed by law to ensure the normal operation of the company, irrespec- 4

tive of charter limitations as to their specific role (art 158 para 2 LSA). In public companies, by contrast, directors and officers are generally only liable for breaches of duties falling within their attributions according to the charter (art 158 para 3 LSA), unless they become aware of a breach by their predecessor or by another director or officer and fail to inform the shareholder meeting, in which case they become jointly and severally liable (art 158 para 4 LSA).

2. Legal personality and its consequences and the appointment, removal and accountability of the board

5 Both corporations and limited liability companies possess *legal personality*, though Brazilian law recognizes certain partnership forms that lack legal personality, such as the *sociedade em conta de participação* and *sociedade em comum* (arts 985, 986 and 993 Civil Code).

6 Corporations and limited liability companies have separate legal personalities, and the principle of *separation of properties* applies.

7 As a general matter, the *liability of shareholders* in corporations is limited to the price of the shares subscribed (art 1 LSA). In limited liability companies, the liability of quotaholders (which is what members of limited liability companies are called) is generally limited to the value of their quotas, but all quotaholders are jointly and severally liable for amounts subscribed but not yet paid in (art 1052 Civil Code).

8 Under the Brazilian Civil Code, disregard of legal entity (or piercing the corporate veil) to reach the assets of shareholders, quotaholders, directors and officers applies in the event of deviation of purpose or comingling of assets (art 50 Civil Code). However, a number of statutory rules and/or judicial decisions provide for *unlimited shareholder liability* in the context of labour, consumer and environmental obligations, irrespective of proof of illicit conduct or abuse on the part of shareholders. Special rules providing for more expansive liability apply to managers and shareholders of financial institutions.

9 A *corporation* has the following mandatory bodies: *assembleia geral* (*shareholders' meeting*) and *diretoria* (*board of officers*), an executive body whose members are responsible for the day-by-day governance of the corporation and its representation before third parties (art 138 LSA). The *conselho de administração* (*board of directors*) is mandatory only for public companies, for companies adopting a system of authorized capital (art 138 para 2 LSA) and for mixed enterprises (corporations created by law in which the government holds a majority of the voting stock) (art 239 LSA). The board of directors is in charge of formulating general business guidelines, appointing, removing, and supervising mem-

bers of the board of officers, as well as approving specific matters as set forth in the charter (art 142 LSA). The *conselho fiscal* (*board of supervisors*) is responsible for the inspection and analysis of the documents of the company. While its formal existence is mandatory, it may operate on a permanent basis or only in certain fiscal years upon the request of certain shareholders (art 161 LSA).

10 The only mandatory body in the *limited liability company* is the *quotaholders' meeting*. The company is managed by one or more *managers* (*administradores*) (art 1060 Civil Code). The articles of association may, but need not, provide for a *board of supervisors* and for a *board of directors* (in the latter case only for companies that opt for the supplementary application of the LSA) (art 1053 Civil Code, sole paragraph, and art 1066).

11 With respect to *corporations*, members of the board of officers are appointed by the general meeting of shareholders or, if there is a board of directors, by the latter (art 143 LSA). Members of the board of directors are elected by the general meeting of shareholders (art 122 II LSA). Directors and officers may be removed at any time by a majority vote of the corporate body in charge of electing them (arts 122 and 143 LSA).

12 With respect to *limited liability companies*, the designation of managers takes place in the articles of association or in a separate document (art 1060 Civil Code). The appointment of managers who are not quotaholders requires the unanimous approval by the quotaholders if the capital is not fully paid in and by two-thirds of the quotaholders if the capital is fully paid in (art 1061 Civil Code). The manager holds office until removal or the end of the term set forth in the articles of association, if he or she has not been reappointed (art 1063 Civil Code). Managers can generally be removed at any time. The removal of a manager who is so designated in the articles of association requires the approval of two-thirds of the company's capital, unless the articles of association provide otherwise (art 1063 Civil Code).

13 *Legal entities may not serve as directors* in corporations or limited liability companies.

14 From a comparative perspective, Brazilian law confers exceptionally *broad powers on the shareholders' meeting*, which 'has the powers to decide on all business relating to the purpose of the company and to make all resolutions that it deems convenient to its defense and development' (art 122 LSA). Nevertheless, certain fundamental acts and decisions – such as the election, removal and supervision of corporate officers, and the determination of the general business strategy of the company, are the province of the board of directors (art 142 LSA).

15 Brazil's LSA also gives significant power to *shareholder agreements*, which are very common in corporate practice. The statute provides that a director's vote that is in violation of a duly filed agreement shall not be counted by the chairperson of the meeting (art 118 para 8 LSA). In addition, if a director ap-

pointed under the terms of a shareholders' agreement abstains from voting or does not attend the relevant board meeting, the director appointed by the aggrieved party may vote in his or her name (art 118 para 9 LSA). Under Brazilian law, however, directors owe *fiduciary duties* to the company, not to the shareholders (arts 154 and 155 LSA). Consequently, the relationship between directors' fiduciary duties, on the one hand, and the binding force of shareholders' agreements, on the other, is a difficult one and remains largely unsettled.

16 *Limited liability companies* in Brazil are *not required* to have a board of directors or a board of supervisors, and only rarely have them (see no 10 above).

17 With respect to *corporations*, Brazil follows a hybrid system that falls in between the one-tier and two-tier models for corporate boards. *Public companies* must follow a two-tier structure with a board of directors (*conselho de administração*) and a board of officers (*diretoria*), while *private corporations* may opt for a one-tier structure comprising only the board of officers. Nevertheless, the *diretoria* can, but need not, operate as a board proper: unless the charter provides for joint deliberations in the form of a board meeting, officers can make decisions and bind the company individually within the scope of their powers.

18 Members of the *board of directors* are generally *appointed by shareholders* only, though large companies controlled by the federal government are required to have one employee representative on their board (Law 12,353 of 28 December 2010). Shareholders holding at least 10% of the voting capital are entitled to demand cumulative voting in director elections (art 141 LSA). In public companies, common shareholders holding at least 15% of voting shares, as well as preferred shareholders holding at least 10% of non-voting preferred shares, are entitled to appoint and remove one board member each (art 141 para 4 LSA). Shareholders can remove directors at any time.

19 Brazil's LSA also contemplates a *board of supervisors* (*conselho fiscal*) (see no 9 above), whose members are *appointed by the general meeting of shareholders* (art 161 LSA). Non-voting preferred shareholders, as well as common shareholders holding at least 10% of voting stock are entitled to elect one member and the respective alternate directors (art 161 LSA).

3. The qualifications of board members

20 Corporate *directors* must have an '*untainted reputation*' (art 147 para 3 LSA), but are not otherwise subject to specific requirements in terms of education or professional skills. Persons who have been convicted of various financial crimes or have been disqualified by the Securities Commission (CVM) are not eligible to serve as directors (art 147 LSA). Unless exempted by the shareholders' meeting,

persons holding office in competitors or having a *conflict of interest* with the company are also ineligible as directors (art 147 para 3 LSA).

Officers of a corporation must be *domiciled in Brazil* (art 146 LSA). 21

Members of the *board of supervisors* must be individuals domiciled in Brazil 22
who have either completed university education or have served for at least three years as a director, officer or member of a board of supervisors (art 162 LSA).

4. Investigations into directors' misconduct

The *board of supervisors* is empowered to *investigate misconduct* on the part of 23
the board of directors and the board of officers. For such purposes, it can request information from *independent auditors* or hire accountants and auditors to supply it with the information necessary for the performance of its duties (art 163 I paras 4 and 5 LSA). The board of supervisors may operate on a permanent basis or only in certain fiscal years at the request of shareholders representing 10% of voting stock or 5% of non-voting preferred stock. The charter may not eliminate the shareholders' right to request the installation of the board of supervisors. The board of supervisors must provide shareholders holding at least 5% of total capital with the information they request on matters within its jurisdiction. The powers of the board of supervisors under the LSA may not be limited by the corporate charter or in any other relevant way.

Public companies, as well as certain 'large-scale' companies, must carry out 24
independent audits with auditors registered with CVM (Brazil's Securities Commission). 'Large-scale entities' are companies or groups of companies which in the previous fiscal year had total assets exceeding BRL 240,000,000 or gross income revenue exceeding BRL 300,000,000 (Law 11.638 of 2007, art 3).

II. Liability for Damage Caused to the Company and to the Shareholders

A. General requirements – scope of duties and violation of duty of care of directors

5. Liability of the board and its members

As a general rule, only the company is liable for its contracts and torts. How- 25
ever, directors and officers can be held personally liable if they act (i) within

their powers but with *negligence or willful misconduct* (art 158 I LSA; art 1016 Civil Code) or (ii) in *violation of the charter or articles of association* (art 158 II LSA). Violations of law include the breach of fiduciary duties of care and loyalty. In contrast to the general regime applicable to contractual and tortious liability, the LSA permits the judge to exempt from liability directors and officers who acted in good faith and in view of the interests of the company (art 159 para 6). Under art 135 of the Federal Tax Code, officers are personally liable for tax liabilities resulting from illegal acts or acts performed in violation of the charter or bylaws of the company.

6. General statutory and non-statutory duties of the board and its members

26 Brazil's LSA describes the *fiduciary duties* applicable to directors and officers of corporations. These rules are also applicable to managers of limited liability companies by analogy.

27 *Duty of care* (*dever de diligência*) (art 153 LSA; art 1011 Civil Code): Directors and officers shall carry out their functions with the *care and diligence that every responsible person applies in the management of his or her own business*. Directors and officers may not borrow company funds or use company assets, services or credit for their own benefit in the absence of prior shareholder or board approval (art 154 para 2 b LSA). Unless authorized by the shareholders' meeting or by the board of directors, directors and officers may not receive any direct or indirect personal advantage as a result of their position as director or officer of the company (art 154 para 2 c LSA). Directors and officers cannot generally perform gratuitous acts at the expense of the company, though the board of directors and the board of officers may authorize reasonable gratuitous acts for the benefit of workers and the community in view of the company's social responsibilities (art 152 para 2 a and para 4 LSA).

28 *Duty of loyalty* (*dever de lealdade*) (art 155 LSA): Directors and officers must *serve with loyalty to the company*, and may not (i) take advantage of the commercial opportunities which they find out as a result of their service to the company, (ii) refrain from protecting the interests of the company or refrain from taking advantage of business opportunities in the interests of the company in order to benefit themselves or third parties, or (iii) acquire assets or rights that are necessary to the company, in order to resell at a profit. The duty of loyalty also encompasses the duty of confidentiality and the duty to refrain from trading based on material non-public information (insider trading).

29 The statute also provides specific rules on *conflicts of interest*. The director or officer may not vote or intervene in any transaction in which it has a conflict

of interest with the company. Even if the conflicted director or officer has not intervened or voted to approve the related-party transaction, such transaction is still required to be reasonable or fair, in an identical manner to those available in the market or to which the company would be able to contract with third parties (art 156 LSA). The director or officer must disclose their relationship to the board of directors or the board of officers, as applicable, and ensure that the nature and extent of their interests are appropriately registered in the minutes of the meeting.

Directors and officers of public companies also have specific duties to disclose relevant information, either at the request of 5% shareholders or as imposed by law (art 157 LSA). 30

7. Nature and scope of the duty to act in the best interests of the company

As discussed above, directors' fiduciary duties in Brazil encompass the *fiduciary duties of care and loyalty*, as well as *related obligations* that apply to related-party transactions and *corporate disclosure*. We are not aware of judicial precedents that address the extent to which the relevant duty of care extends beyond the performance of work-related tasks to include aspects of the board member's personal or private life – an issue that is left open by the statute. 31

7.1. Case Study (safeguarding of interests)

There is *no clear answer* under Brazilian law regarding the possibility of D being held liable in damages to C-Corporation. As mentioned before, the LSA does not directly address whether a director's duty of care may extend beyond his actions as a director, and we are aware of no judicial precedents on point. 32

7.2. Case Study (fiduciary duty and conflict of duties)

There is a strong argument that D may not be held liable in damages to C-Corporation. As discussed above, *fiduciary duties in Brazil are owed to the company*, not to shareholders. Indeed, the statute expressly provides that the director or officer appointed by a group or class of shareholders owes the same fiduciary duties to the company as other directors or officers, and may not violate such duties to protect the interests of those shareholders who elected them (art 154 para 1 LSA). 33

8. The extent of the board's control and oversight

34 The LSA specifically imposes on corporate *directors* the *duty to supervise the actions of corporate officers* (art 142 III LSA). A number of precedents by the Securities Commission suggest that the duty of care imposed on directors and officers require them to *establish effective systems of internal controls*. For instance, CVM (Brazil's Securities Commission) fined various board members (as well as officers) of the public company Sadia in a case involving risky bets on exchange rates derivatives (which were unauthorized per the company's internal policies and produced major losses in the financial crisis). The Commission found that the directors had failed to oversee the installation of appropriate systems of internal controls and, therefore, violated their fiduciary duties of care.[1] However, the precise contours of such oversight obligations – and the extent to which the business judgment rule may be invoked to exonerate managers with respect to the decisions establishing the mechanisms for internal controls – remain unclear.

9. Responsibility for compliance monitoring

35 As a general rule, *individual directors are not liable for wrongful acts of other directors or officers*, unless they are complicit, negligent in uncovering wrongdoing or, having knowledge thereof, fail to prevent its occurrence. The dissident director is exempted from liability by registering the *dissent* in the minutes of the board meeting or, if that is not possible, by giving written notice thereof to management, the board of supervisors or the shareholders meeting (art 158 para 1 LSA).

36 Nevertheless, as mentioned (see no 4 above), directors and officers in private companies are *jointly and severally liable* for damage caused in breach of the duties imposed by law to ensure the normal operation of the company, irrespective of charter limitations as to their specific role (art 158 LSA para 2). In public companies, by contrast, directors and officers are generally only liable for breaches of duties falling within their attributions according to the charter (art 158 LSA para 3), unless they become aware of a breach by their predecessor or by another director or officer and fail to inform the shareholder meeting, in which case they become jointly and severally liable (art 158 LSA para 4).

1 Processo Administrativo Sancionador 18 of 2008.

9.1. Case Study (liability of individual board members for disadvantageous transactions authorised by the majority in a board meeting)

In both the main and in the alternative hypotheticals, D3 will be *exempted from liability* if his or her *dissenting opinion* was included in the minutes of the board meeting or, if this were not possible, if he or she gave immediate written notice of his or her dissent to the board, the board of supervisors or the shareholders meeting of C-Corporation (art 158 LSA para 1). 37

10. Variation in duties and the standard of care expected of the board and its members under corporate, tort and contract law

The duty of care applicable to corporate directors requires them to act with the same *care and diligence as an active and honest man would in the management of his own business* (art 153 LSA). The need for the board to exercise its judgment and discretion when exercising these duties is addressed by the *Brazilian version of the business judgment rule*. In this respect, the LSA explicitly authorizes the judge to exempt directors from liability if they acted in good faith and in view of the interests of the company (art 159 para 6 LSA). Although the statute refers to the 'judge', CVM (Brazil's Securities Commission) may also resort to this provision to exempt directors and officers from administrative sanctions, as appropriate. 38

10.1. Case Study (concretisation of the standard of duty; Business Judgment Rule)

As long as the decision to expand is disinterested and informed, and the board is able to show its careful analysis of the risks involved, there is a very strong argument for D to avoid liability under the *Brazilian business judgment rule* even if the expansion ultimately results in a loss to the company (art 159 para 6 LSA). The same reasoning applies if D decides not to implement the expansion. 39

11. Factors influencing duties and the standard of care

The duty of care under Brazilian law is enunciated in very general terms; nevertheless, the *concrete determination* of the standard of care will necessarily be 40

context-specific, hinging on the particular facts and circumstances of the case. The so-called Bombril case, brought before the CVM (PAS CVM no 04/99), is representative in the Brazilian market, in which most companies have a controlling shareholder. In this case, the controlling shareholder was held liable for related party-transactions that harmed the *company*, and the directors and officers were held liable for violation of their duty of care in evaluating such transactions.

11.1. Case Study (applicable standard of care)

41 Banking regulations impose *specific standards concerning the duty of care*, to the effect that D may be held liable in damages if he/she did not comply with 'good banking practices'. Brazilian financial regulation also imposes limits on risk-taking by banks as well as on certain kinds of transactions that constitute a violation of good banking practices.[2] Even though Brazilian banks must be incorporated as stock corporations, the *liability of directors, officers, and controlling shareholders is unlimited in the event of insolvency*, so that their personal assets may be frozen (art 36 of Law 6,024 of 13 March 1974).

42 In this case, if D carried out the transaction in a way that constituted a breach of so-called '*good banking practices*', he or she may *not be subject to the business judgment rule*. Even if he or she were subject to the business judgment rule by complying with good banking practices, he or she may still be held liable for damages not only to B-Bank but also to creditors and the supervisory authority.

12. The boards' and its members' duties and liability in the vicinity of insolvency

43 There are *no special duties* applicable to the board, to individual directors or to officers in the case of insolvency. Directors and officers owe their fiduciary duties to the company at all times, and have no specific duty to file for insolvency proceedings.

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2 Resolução (Regulation) No 1,559 of 22 December 1988 issued by the National Monetary Council (*Conselho Monetário Nacional*) prohibits certain practices by financial institutions (such as carrying out transactions which do not meet the principles of selectivity, security, liquidity and risk diversification, or extending credit without proper documentation). Violation of such rules implies a breach of 'good banking practices'.