Liability of Managing Directors under German Stock Corporation Law

Holger Fleischer

I. Introduction
II. Legal Framework for Liability of Managing Directors
 1. Liability to the company (“internal” liability”)
 2. Liability to creditors or shareholders (“external” liability”)
III. Taxonomy of Managing Directors’ Duties
 1. Duty of care
  a) Duty to act lawfully
  b) Duty of care in the narrow sense (and business judgment rule)
  c) Duty to monitor
 2. Duty of loyalty
  a) Duty to not compete
  b) Duty of confidentiality
  c) Duty of loyalty in the narrow sense
IV. Elements of a Cause of Action against Managing Directors
 1. Breach of duty
 2. Fault (and reliance on experts)
 3. Damage to the company
 4. Causation
 5. Burden of proof
V. Enforcement of the Company’s Claim for Damages
 1. Supervisory board
 2. Shareholders
 3. Creditors or insolvency administrator
VI. Conclusion

I. INTRODUCTION

Legal rules for directors’ liability in German stock corporations had long been “law in the books”. Court decisions were rare and the risk of incurring personal liability appeared to be minimal. This has changed dramatically over the last years. Today, liability disputes between directors and their companies seem to abound, and in many instances are covered on the front pages of business newspapers.[1]

---

1 See FLEISCHER, Aktuelle Entwicklungen der Managerhaftung, NJW 2009, 2337; more comprehensively in ‘English’ FLEISCHER, The Responsibility of Management and its Enforcement, in Ferrarini/Hopt/Winter/Wymeersch (eds.), Reforming Company and Takeover Law in Europe, 2004, p. 373 et seq.; most recently also GUBITZ / NIKOLEYCZIK / SCHULT,

Here are some examples of high profile cases that have recently been decided or are still pending in the German courts:

- After discovering schemes of corruption and bribery, blue chip companies like the engineering and electronics multinational Siemens or the truck maker MAN are suing their former executives for lack of oversight.
- Liability suits have also been prepared against former directors of the German bank IKB which almost faced insolvency in the wake of the worldwide financial crisis because of large investments in the U.S. securitisation market.
- The insolvency administrator of the German retailer Arcandor has asserted liability claims against former managers who allegedly received excessive executive compensation.
- Former managers of the Bayern LB, a state-owned Bavarian bank, are being taken to court for a failure to conduct a proper due diligence procedure before buying a controlling stake in Hypo Alpe Adria, an Austrian lender that had to be nationalised last year.

As most liability suits are settled silently outside the courtroom, these cases are only the tip of the iceberg.

II. LEGAL FRAMEWORK FOR LIABILITY OF MANAGING DIRECTORS

Before moving to the details of directors' liability, it might be helpful to briefly outline the broader legal framework.[2] A specific feature of German stock corporation law is the separation between a management board ("Vorstand") and a supervisory board ("Aufsichtsrat"). The management board consists of inside directors only and is responsible for running the day-to-day business of the firm. The supervisory board is exclusively made up of outside directors, that is, representatives elected by the shareholders or appointed by the employees of the firm. My following remarks will only address the liability of managing directors.

1. Liability to the Company ("internal" liability)

To examine this topic, it is first important to understand the general rule that directors' duties are owed to the company itself, and that it is primarily the *company* which has the task of, and the responsibility for, enforcing them. Reflecting this concept, § 93 II of

---

Manager Liability in Germany. Director Liability of Members of Management and Supervisory Boards of German Companies, 2012.

2 For a reliable source in 'English' WIRTH / ARNOLD / MORSHÄUSER / GREENE, Corporate Law in Germany, 2d ed. 2010; see also V. DRYANDER / RIEHMER (eds.), Being a Board Member in Germany: A manual for English-speaking members of management boards and supervisory borads of German AG, GmbHG and SE, 2011.

German Stock Corporation Act stipulates the "internal" liability of managing directors vis-à-vis the company: "Members of the management board who fail to comply with their duties shall be jointly and severally liable *to the company* for any resulting damage." In case law and doctrinal writing, this concept is also known as the "principle of channelling liability" through the company ("Prinzip der Haftungskanalisierung"): The company, and not its creditors or shareholders, is entitled and responsible for asserting damage claims against members of the management board.[3]

2. *Liability to Creditors/Shareholders ("external" liability)*

"External" or direct liability of managing directors towards creditors or shareholders of the company according to German Stock Corporation Law, is confined to exceptional cases such as fraud. An important example is the case law concerning the liability of managing directors for releasing false statements about the situation of the company in publicly distributed information. In the famous Infomatec case in which shareholders bought stock relying on incorrect ad hoc announcements of the company, the Federal Court of Justice decided in 2004 that managing directors incur personal liability pursuant to § 826 of the Civil Code for false ad hoc reports.[4] This section of German tort law provides that a person who deliberately and in violation of good morals causes damage to another person is obliged to pay damages. This paper however, will not cover "external" liability and confine itself to the more important field of "internal" liability.

III. TAXONOMY OF MANAGING DIRECTORS' DUTIES

From the common law systems we know the difference between the duty of care and the duty of loyalty.[5] This taxonomy of directors' duties has now also come to be widely accepted in German legal doctrine.[6]

1. *Duty of Care*

Under the broad heading "duty of care", commentators usually discuss three distinct duties: the duty to act lawfully, the duty of care in the narrow sense and the duty to monitor.[7]

---

3 See BGH NZG 2012, 992, 994; BGHZ 125, 366, 375 f.; FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 307; FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 335.

4 See BGHZ 160, 134; BGHZ 160, 149.

5 See KRAAKMAN / ARMOUR / DAVIES / ENRIQUES / HANSMANN / HERTIG / HOPT / KANDA / ROCK, The Anatomy of Corporate Law, 2d ed. 2009, p. 79-80, 173-174.

6 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 6; FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 7.

a) Duty to Act Lawfully

It should go without saying that managing directors have a general obligation to avoid violating regulatory laws. However, managing directors sued for setting up a cartel or a corruption scheme defend themselves by contending that they acted in the interests of the company. After all, they argue, violating the law can be profitable and should be a permissible choice under the business judgment rule, given the high anticipated profits and the low detection rate of cartels and corruption schemes. This idea is similar to, and borrowed from, the theory of efficient breach in contract law. The German Federal Court of Justice, in two recent criminal cases involving Siemens and the energy giant RWE, explicitly rejected the idea of an efficient breach of public law: The law, they argued, cannot, and should not, adopt a deliberate policy to encourage its own violation.[8]

b) Duty of Care in the Narrow Sense (and Business Judgment Rule)

The duty of care in the narrow sense is the most fundamental duty of managing directors. It is defined in § 93 I AktG as requiring them to act with the diligence of a prudent businessman in the affairs of the company. Clear cut violations include distributions of corporate assets contrary to the provisions of the Stock Corporation Act, the repayment of contributions to shareholders or the granting of corporate loans to third parties without adequate securities. Interesting case law is also evolving in the M & A context where it is generally regarded as a breach of duty when managing directors acquire a target company in a share or asset deal without a proper due diligence procedure.[9] A nice illustration is the disastrous decision of the BayernLB to take over Hypo Alpe Adria – a deal in which BayernLB lost more than four billion euros. Here, the liability claim of the company is based on the ground that BayernLB managers should not have concluded the acquisition of Hypo Alpe Adria in the way they did, taking into account all the information available (in particular due diligence, purchase price, purchase agreement and the acquisition procedure).

On the other hand, it is pretty clear that managing directors need some sort of protection if business decisions turn out to be wrong: Part of consciously taking chances in business is the danger of false assessments and miscalculations, to which every manager is exposed, no matter how responsible his actions. In order to ensure that managers can take reasonable risks without a constant fear of lawsuits, U.S. law has developed the

---

7 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 12; FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 12.

8 See BGH NJW 2011, 88, 92 (Siemens/AUB); BGH NZG 2010, 1190, 1192 (RWE); FLEISCHER, Aktienrechtliche Legalitätspflicht und „nützliche“ Pflichtverletzungen von Vorstandsmitgliedern, ZIP 2005, 141.

9 See OLG Oldenburg NZG 2007, 434, 436; FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 87; FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 100.

business judgment rule. This rule was adopted by the German Federal Court of Justice in its 1997 ARAG/Garmenbeck decision[10] and recently codified in the German Stock Corporation Act. According to § 93 I 2 AktG, there is no breach of duty if the managing directors, at the time of taking an entrepreneurial decision, had good reason to assume that they were acting on the basis of adequate information for the benefit of the company. This provision establishes a safe harbour rule for managing directors.[11] In practice, its two most important conditions are (1) that the measure in question is a business or entrepreneurial decision and (2) that the managing directors were acting on the basis of adequate information, taking into account the importance of the business measure in question.[12] The latter requirement was allegedly missing in the case of BayernLB/Hypo Alpe Adria although the acquisition of a company is generally an entrepreneurial decision within the scope of the business judgment rule. Other examples of entrepreneurial decisions include the launch of a new product or major investments in a new technology. A case on point is the 2007 Deutsche Telekom decision of the Federal Court of Justice[13]: In an auction held by the German Federal Government in 2000, Deutsche Telekom acquired a license for mobile telecommunication according to the UMTS standard for more than 8 billion euros. The investment turned out to be unsuccessful, to say the least, but the Court could find no breach of duty because the management decision was well prepared and the UMTS technology, at that time, seemed particularly promising. Evidence of this, the Court said, could also be found in the fact, that all competitors of Deutsche Telekom participated in that auction and that outside banks were willing to finance the acquisition with major loans.

c) Duty to monitor

A third application or variation of the duty of care is the duty of oversight: It requires managing directors to monitor the activities of employees. Legislators and courts have constantly expanded these oversight duties over the years and emphasized their organisational dimension. According to § 91 II AktG, newly enacted in 1998, the management board must introduce appropriate measures, in particular setting up a monitoring system, in order to ensure that any developments endangering the continued existence of the company may be identified early on.

Going beyond early warning systems, it is now widely accepted that companies with a significant risk exposure have to establish a company- or even group-wide compliance system. This requirement has found its way into the German Corporate Governance Code in 2007: Section 4.1.3 requires the management board to ensure that all provisions of law and the enterprise's internal policies are abided by and that it strives to achieve

10 See BGHZ 135, 244.

11 See FLEISCHER, Die „Business Judgment Rule“: Vom Richterrecht zur Kodifizierung, ZIP 2004, 685, 688-689.

12 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 66 et seq., 73 et seq.

13 See BGHZ 175, 365, 368 et seq.; FLEISCHER, Das UMTS-Urteil des BGH, NZG 2008, 371.

their compliance by group companies. Section 5.3.3 adds that the supervisory board shall set up an audit committee, *inter alia*, to handle risk management and compliance. To illustrate the magnitude of this compliance requirement for listed companies: Siemens has increased the number of employees within the compliance function from 83 in 2006 to 170 in 2007 and 621 in 2010.

2. *Duty of Loyalty*

a) *Duty to not compete and duty of confidentiality*

Unlike the duty of care, the duty of loyalty has only been codified by the German Stock Corporation Act in a rudimentary fashion: § 88 I AktG prohibits management board members from competing with the company in its line of business during their employment, and § 93 I 3 AktG stipulates a statutory duty of confidentiality. The general concept, however, is not mentioned in the Act which has caused considerable difficulties in shaping the duty of loyalty.

b) *Duty of loyalty in the narrow sense*

Over the years, contributions from comparative law scholarship have helped to fill in the gaps and to flesh out the law of fiduciary obligations. The duty of loyalty has since become firmly entrenched in the case law[14], and the German Code of Corporate Governance highlights some of its most important features, for instance, a duty to disclose conflicts of interest to the supervisory board without delay and to inform the other members of the management board thereof.[15]

Another important example is the corporate opportunities doctrine which the courts began to shape in the 1970s, relying heavily on comparative insights. This has now developed into a rich body of case law and extensive academic writing.[16] In defining a corporate opportunity, similar tests have emerged as under U.S. law. An often-cited decision of the Federal Court of Justice has rejected a distinction between business opportunities offered to the director in his corporate capacity and those offered to him in a private context.[17] The rationale behind this seems to be that fiduciary duties are indivisible and that a managing director is always on duty ("ein Geschäftsführer ist immer im Dienst").[18]

14 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 113 et seq.
15 See sec. 4.3.4 of the German Corporate Governance Code.
16 See FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 175 et seq.
17 See BGH NJW 1986, 585, 586.
18 Critical of this FLEISCHER, Gelöste und ungelöste Fragen der gesellschaftsrechtlichen Geschäftschancenlehre, NZG 2003, 985, 989.

IV. Elements of a Cause of Action against Managing Directors

Moving on to the requirements for managing directors' liability, there are four distinct elements which I will briefly outline in order: (1) breach of duty, (2) fault, (3) damage to the company and (4) causation.

1. *Breach of duty*

With respect to a breach of duty, I can refer to the duty of care and duty of loyalty explained above.[19]

2. *Fault*

In Germany, as in most other jurisdictions, there is no strict liability for managing directors. Liability requires the intentional or negligent breach of directors' duties. This standard is *objective* in the sense that a director will not succeed with the defence that he has acted with such care as he would apply in his own affairs. Moreover, the standard is *compulsory* and cannot be modified by the articles of association or in the individual contract with the director.[20] In theory, the breach of a duty and the question of whether it occurred negligently, must be neatly distinguished. In practice, these two questions often merge into one.[21]

There is at least one area, however, where the negligence requirement retains an individual importance: In two recent cases, managing directors violated their duty of care by not filing for insolvency in due time or by disregarding the statutory conditions for a company's acquisition of its own shares. In response to damage claims by the company, they argued that they relied on expert advice from an auditor or corporate counsel. The courts have shown themselves willing to accept this defence under certain conditions. In 2009, the Higher Regional Court of Stuttgart held that a managing director is not negligent if (a) he relied on the opinion of an independent and sufficiently qualified expert who (b) has been provided with all relevant facts of the case and (c) this opinion withstands a plausibility check by the managing director.[22] The Federal Court of Justice has confirmed this line of reasoning in two most recent decisions.[23]

19 See III 1. and 2.

20 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 3; more scope for private ordering using indemnification clauses for managing directors is left in the GmbH; see FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 298 et seq.

21 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 255.

22 See OLG Stuttgart NZG 2010, 141.

23 See BGH NZG 2011, 1271, 1272 et seq. (ISION); BGH NZG 2012, 672, 673; FLEISCHER, Vertrauen von Geschäftsleitern und Aufsichtsratsmitgliedern auf Informationen Dritter – Konturen eines gesellschaftsrechtlichen Vertrauensgrundsatzes, ZIP 2009, 1397; FLEISCHER, Vorstandshaftung und Vertrauen auf anwaltlichen Rat, NZG 2010, 121.

3. *Damage to the Company and Causation*

As a third and fourth requirement, the company must have suffered damages as a consequence of the breach of duty. In the aforementioned cases of illegal cartels and corruption schemes, a difficult and still unresolved question is whether the fines and penalties imposed on the company according to § 130 of the Administrative Offences Act ("Gesetz über Ordnungswidrigkeiten") are recoverable from the managing directors personally under § 93 II AktG.[24] This is no by no means a trivial question: Siemens, for example, had to pay a fine in the amount of 395 million euros.

4. *Burden of Proof*

In deviation from general law principles, § 93 II 2 AktG stipulates a partial reversal of the burden of proof: The company only has to prove that (a) there was an action or omission by the respective member of the management board, and (b) that it has suffered damage as the result of such action or omission. The managing director, on the other hand, has the burden of proving that (a) he acted with the diligence of a prudent businessman and (b) that his action or omission did not constitute a breach of duty.[25]

5. *Interim Result*

Looking at these requirements for a cause of action, one can safely say that the liability regime for managing directors under the German Stock Corporation Act is of considerable rigor: Managing directors are liable even for slight negligence, and they face a partial reversal of the burden of proof. Only the business judgment rule offers them some sort of protection. However, as we all know from comparative experience, the sting in the tail of a liability clause is found largely in its enforcement.

V. ENFORCEMENT OF THE COMPANY'S CLAIM FOR DAMAGES

This brings me to the last point of this paper: Who is entitled to assert the company's damage claim against the managing directors? The answer is threefold:

1. *Supervisory Board*

First, it is within the responsibility and competence of the supervisory board to pursue damage claims against managing directors. For a long time, the prevailing opinion in Germany held that the supervisory board had broad discretion as to the enforcement of the company's damage claim. This changed due to the ARAG/Garmenbeck decision of

---

24 See FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 263.
25 See BGHZ 152, 280, 284.

the Federal Court of Justice from 1997[26], perhaps the most influential case in German Stock Corporation Law within the last fifteen years. In this decision, the court developed a three-prong test for the assertion of damage claims by the supervisory board:

- (1) The function of the supervisory board as monitor of the work of the management board gives it a duty to verify in its own responsibility the existence of the stock corporation's claims for damages against members of the management board.
- (2) If the supervisory board reaches the conclusion that the management board is liable for damages, it has to assess whether and to what extent legal action would allow for compensation of the damages based on careful and proper risk analysis.
- (3) If, according to the supervisory board's assessment, the stock corporation does have valid claims for damages, then the supervisory board has to initiate legal proceedings as a general rule. It may only deviate from this general rule as an exception, if important reasons for the good of the company militate against this and if those reasons outweigh the reasons that militate in favour of the legal proceedings, or are at least equivalent. Aspects other than those for the good of the company, that personally affect members of the management board, may only be considered by the supervisory board in exceptional cases.

Despite this clear language from the Federal Court of Justice, supervisory boards in the real world are still reluctant to take action against managing directors, mostly for two reasons: To begin with, a lawsuit could bring up evidence that the supervisory board failed to perform its own role, namely to control the management board. Moreover, members of the supervisory board are often former managing directors and may for reasons of collegiality shy away from pursuing the company's claim.

2. *Shareholders*

Generally, individual shareholders cannot bring a damage claim on behalf of the company or in their own right, However, § 148 AktG allows shareholders with a 1% holding to bring a damage claim in their own name. In practice, this avenue is rarely pursued due to the cumbersome process and the fact that any compensation goes to the company.

3. *Creditors or insolvency administrator*

According to § 93 V 1 AktG, creditors of the company may also claim damages for amounts outstanding and otherwise unrecoverable from the company. In practice, the scope of this provision is limited. Where insolvency proceedings have commenced, it is the insolvency administrator who exercises the company's right.

---

26 See BGHZ 135, 244.

VI. CONCLUSION

Summing up, one can safely say that public awareness of directors' liability as well as the willingness to raise claims against managing directors have been growing over the last years. The legal provisions of personal liability are no longer a blunt sword. High profile and widely published cases are definitely developing a significant preventative function. A good yardstick for this is the rising interest in, and importance of, D&O insurance.[27] Insurance premiums reflecting the growing liability risk are approaching an all-time high.

27 See FLEISCHER, in: Spindler/Stilz, Aktiengesetz, 2d ed. 2010, § 93 n° 225 ff.; FLEISCHER, in: Münchener Kommentar zum GmbH-Gesetz, 2011, § 43 n° 374 et seq.

ANNEX:

§ 93 Stock Corporation Act
(Duty of care and responsibility of members of the management board)[28]

"(1) The members of the management board shall apply the due care of a diligent and conscientious manager in managing the company. There is no breach of duty if the member of the management board, in the case of an entrepreneurial decision, could reasonably assume to be acting on the basis of adequate information and for the benefit of the company. The members of the management board shall keep confidential information and secrets of the company, namely trade or business secrets which they obtained knowledge of from their activity on the management board […]."

(2) Members of the management board who fail to comply with their duties shall be jointly and severally liable to the company for any resulting damage. In the event of a dispute as to whether or not they applied the due care of a diligent and conscientious manager, they shall bear the burden of proof. If the company obtains insurance covering a member of the management board against risks from their professional activity for the company, a deductible of at least ten percent of the damage at least up to the level of one-and-a-half times the fixed yearly compensation of the member of the management board shall be provided for.

(3) The members of the management board shall in particular be liable if, contrary to the provisions of this Act,

1. contributions are repaid to shareholders,
2. the shareholders are paid interest or granted a share in the profits,
3. own shares of the company or another company are subscribed to, acquired, pledged or redeemed,
4. shares are issued before the issue price has been paid in full,
5. corporate assets are distributed,
6. payments are made in contravention of sec. 92 para. 2,
7. remunerations are paid to supervisory board members,
8. credit is granted,
9. new shares are issued at a contingent capital increase for a purpose other than that specified or before the price therefore has been paid in full.

---

28 Translation taken from WIRTH / ARNOLD / MORSHÄUSER / GREENE, Corporate Law in Germany, 2d ed. 2010, p. 330 et seq.

(4) The members of the management board shall not be liable to the company for damages if the action was taken on the basis of a lawful resolution of the general meeting. The fact that the supervisory board approved the action shall not exclude liability for damages. The company may only waive or compromise claims for damages three years after such claims arise and then only if the general meeting grants its consent and no objection is raised in the minutes by a minority of shareholders whose aggregate holding amounts to one tenth of the registered share capital. The time limit shall not apply if the party liable for the damage is illiquid and enters into a composition with his creditors in order to avert insolvency proceedings or if the liability for damages is regulated in an insolvency plan.

(5) The company's claim for damages may also be asserted by creditors of the company to the extent that said creditors are unable to obtain fulfilment of their claims from the company. In cases other than those pursuant to para. 3, however, the foregoing shall only apply if the members of the management board have grossly breached the duty of care of a diligent and conscientious manager; para. 2 sentence 2 shall apply accordingly. The liability for damages is not excluded vis-à-vis the creditors by a waiver or composition by the company or by the fact that the act which caused the damage is based on a resolution of the general meeting. If insolvency proceedings have been commenced against the assets of the company, the insolvency administrator or the custodian shall exercise the company's rights against members of the management board for the duration of such proceedings.

(6) Claims arising from these provisions shall become time-barred after five years."

§ 116 Stock Corporation Act (Duty of care and responsibility of supervisory board members)[29]

"Sec. 93 with the exception of para. 2 sentence 3 on the duty of care and responsibility of the members of the management board shall apply accordingly to the duty of care and responsibility of the members of the supervisory board. The members of the supervisory board are under a particular obligation not to disclose any details concerning confidential reports they obtain and confidential discussions. They shall in particular be liable for damages if they determine an unreasonable compensation (sec. 87 para. 1)."

---

29 Translation taken from WIRTH / ARNOLD / MORSHÄUSER / GREENE, Corporate Law in Germany, 2d ed. 2010, p. 383.