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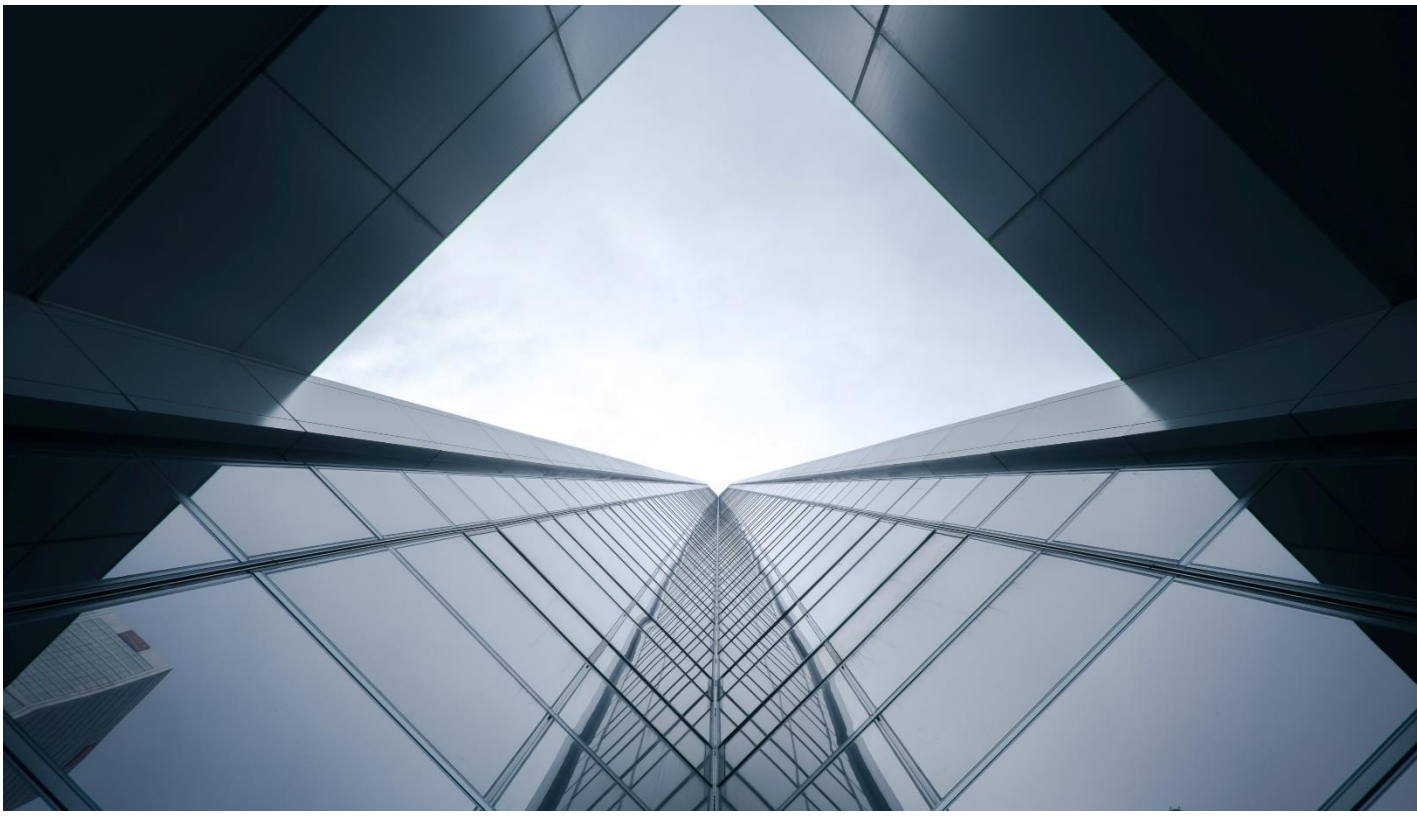

DISCHARGE AND INSURANCE

27 March 2022

1. Introduction

Directors and officers are exposed to the risk of liability when engaging in their formal duties as a part of the management of the company and the number of liability cases against directors and officers. Many companies have taken out a directors and officers' insurance ("D&O Insurance") to cover the risk associated with the management profession. Over the years, Moalem Weitemeyer has been involved in several liability cases, where claims have been raised against the management of companies. When representing management, in practice this is often done in close collaboration with the management member's insurance company.
Recent developments in the D&O Insurance market have, however, made it more difficult for companies to take out the D&O Insurance with adequate coverage at acceptable premiums. Accordingly, an increasing number of companies have resolved to indemnify the management for claims against the management, either on its own or as a supplement to a D&O Insurance.

The development in the prices and coverage of D&O Insurances has, over the past two years, caused 12 out of the 24 listed companies in the Danish C25 index to indemnify the management for claims.

In this newsletter, we will look into the implications of such indemnification, including the requirements for establishing indemnification and other remedies available. The newsletter will first provide a brief overview of the general duties and obligations of the management. Afterwards, the newsletter will examine the possibilities of establishing indemnification and its consequences.

2. Duties and Obligations of Management in general

Directors and officers have a wide range of statutory duties and obligations according to the Danish Companies Act. Among other things, they consist of the following:

- an obligation to exercise care and diligence;
- a duty to exercise their powers and their duties in good faith in the best interests of the company and for a proper purpose;
- a duty to avoid conflicts of interest between themselves and the company;
- a duty to disclose personal interests and not to improperly use their position or information; and
- ensure that the company's capital resources are sound at all times, including having sufficient liquidity to meet the company's current and future obligations.

The D&O Insurance will usually cover directors and officers for damages and defense costs as well as other related costs incurred due to claims against them. The claims against members of the management will typically be raised by either the company itself, the shareholders, regulators, or creditors.

If a member of the management is found to have breached the statutory duties and obligations and the legal basis of liability is present, the member of the management may be ordered to pay damages to e.g., shareholders or to pay a fine to a regulatory authority. This amount will be in addition to the management’s own legal costs and the legal costs of the regulator or the injured party who raised the claim.

The standard of liability applicable in Denmark, the costs of defense against claims, and the resulting financial implications may be very different in other jurisdictions, thus making it essential to have appropriate coverage in place in the relevant jurisdictions. Also, while claims in Denmark are generally directed against the company, the risk of personal liability for management, especially in other jurisdictions, makes it even more important to consider appropriate coverage.

3. Directors and Officer's Liability - recent Developments

The general development of the D&O Insurance market and the increase in liability cases against the management of the company has made it more difficult for companies to take out D&O Insurance that includes both the necessary coverage and a reasonable premium.

As a result, the management in an increasing number of large Danish companies have in several cases proposed as a part of the general meeting to adopt a possibility for the company to resolve to indemnify present or former members of the management as an alternative or supplement to the D&O Insurance.

The management of the companies in question have explained that the background for the proposal is that the D&O Insurance coverage for management liability cases is not high enough and does not provide adequate coverage of the risk assumed by the management. In order for the D&O Insurance to be attractive and meaningful for the management and the company, there must be coherence between the premium paid and the coverage offered.

It has thus been the opinion of the management in several companies that the coverage offered has been far from sufficient. This has especially been an issue for large companies, e.g. listed companies in the banking sector and in the insurance industry, which are exposed to risks to a greater extent.

The need for adequate coverage under the D&O Insurance is not solely a question of providing better protection for the management, but it is also considered to be necessary in order for large companies to attract and retain the most skilled employees, who are exposed to greater risk as a consequence of their positions and duties.

4. Implications of the Decision to indemnify Management

The indemnity typically implies that the costs of defense against claims raised against members of management and damages etc. awarded to a claimant are paid by the company to the extent that is not covered by a D&O Insurance. This includes both the ongoing costs and the final costs, damages etc., once the case is settled with certain limitations, e.g., in relation to criminal acts. Further, members of management should be compensated for any tax payable by them, since when the company undertakes to pay said expenses, damages etc., are taxable as income, as opposed to coverage under a D&O Insurance.

The decision to indemnify management must, in respect of the board, be made by the general meeting since the indemnification is likely to be considered part of the remuneration package available to the board. Further, in listed companies, the decision should be in accordance with the remuneration policy, which may have to be amended as a consequence of this.

5. Legal Extent of granting Discharge

In a Danish context, a D&O Insurance often proves useful in case of bankruptcy of the company since, as stated above, claims in Denmark are generally first brought against the company and against management only in the event that the company is unable to pay.

As any indemnification provided by the company is only of use in case the company is actually able to pay, an indemnification may thus always be sufficient to provide adequate coverage for management, unless the undertaking by the company is supported by a third party, e.g., a major shareholder.

Further, the company, represented by its shareholders at the general meeting, may, under mandatory Danish law resolve to raise a liability claim against the management of a company for any breach of the management's duties causing damages and losses for the company. This is also the case when the shareholders at the annual general meeting have granted discharge to the management if later it turns out that management has not provided information with respect to the matter giving rise to the claim, which materially is considered correct and adequate. Danish courts have shown that they are willing to interpret this exception broadly, and a general discharge of liability may thus have a very limited legal effect.

It should be noted that the discharge will likely be considered as an integrated part of the company's remuneration policy, and as such will have to be adopted by the shareholders at the general meeting.

In addition, any discharge granted to the management of a company does not prevent any subsequent bankruptcy estate from raising liability claims against the former management. The bankruptcy estate is thus entitled to raise liability claims for damages within 24 months after the general meeting's decision to grant discharge to the management for any loss suffered as a consequence of the management's liable actions. The same applies for creditors and third parties who are also not bound by the general meeting's decision to grant discharge. In cases where the company is insolvent, D&O Insurance has proven very useful for members of management.

However, the indemnification can give the board members extended protection from third party claims directed against the management personally, including claims by individual shareholders, especially outside of Denmark. This is especially the case with respect to major companies with an international shareholder base and/or operations in different jurisdictions, where the company is likely to remain solvent, but where the costs by members of management of defending against legal actions initiated against them and the financial outcome thereof may be devastating.

The advantages of granting discharge to management as a supplement to obtaining a D&O Insurance are, therefore that large companies avoid paying expensive premiums for an insufficient insurance coverage, which may not reflect or take the company's actual risk profile into consideration. At the same time, it makes it more attractive and easier for companies to attract qualified management members. On the other hand, the general meeting's decision to grant discharge does not, without exceptions, prevent stakeholders from raising liability claims against the management and should therefore not be considered as full insurance coverage for the management but should be seen as a supplement to D&O Insurance.

6. Our Comments

We note that the trend of large companies granting indemnification as a supplement to D&O Insurance seems to continue. However, we still believe that D&O Insurance will likely continue to play a major role for the companies, especially

due to the protection provided in case of bankruptcy. When used carefully, however, an indemnification by the company is a useful and beneficial way of bridging a gap between protecting management from personal, devastating claims and ensuring that this can be done on reasonable terms.

In this connection, it is important to keep in mind that despite a high insurance premium in some cases, there are still many benefits of a D&O Insurance. Although in Denmark there is not traditionally a distinctly strict management responsibility for members of the management of a company, a D&O Insurance provides security for all parties in connection with a potential dispute. The insurance usually covers both the Executive Board and the Board of Directors. This benefits all parties in that it ensures that there is coverage, regardless of who is finally made responsible, and in that the possibility of the two governing bodies going against each other during a trial is avoided.

If you have any questions or require further information regarding any of the above, please do not hesitate to contact us:

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