Moalem Weitemeyer

Moalem Weitemeyer
Advokatpartnerselskab
Amaliegade 3
DK-1256 Copenhagen

Tel. +45 7070 1505
moalemweitemeyer.com

CVR 3162 7885

NEW GUIDANCE FROM THE DANISH BUSINESS AUTHORITY ON COMPANIES' INDEMNIFICATION OF MANAGEMENT AND BOARD

09 MAY 2023

Introduction

In recent years, Danish companies' have steadily increased their focus on indemnification of its management against damages and costs in connection with third-party claims against the individual members of the executive management and board of directors.

Due to increasingly complex national and European regulation as well as claimants' wider access to judicial review through class-action lawsuits and litigation funding, Danish companies have turned their attention to Directors and Officers Insurance ("D&O-insurance") and corporate indemnification resolutions in order to attract and retain qualified individuals to

management. Due to rising insurance premiums along with extensive focus on management liability, indemnification by the company has become more common and has been adopted as an alternative or supplement to D&O-insurances.

Consequently, within the last years, a majority of the companies comprised by the Nasdaq Copenhagen C25 index have adopted resolutions of management indemnification at their general meetings. Until now, it has been debated whether companies under Danish law could validly adopt a resolution of general and broad indemnification of its board of directors. In a Danish Business Authority guidance note from 13 April 2023, the possibility to adopt such has been clarified, providing firmer legal basis for such resolutions being relied on and considered valid.

Management Liability in Danish law

Pursuant to section 361 of the Danish Companies Act, members of management who intentionally or negligently cause a loss for the company during the course of their duties may be held liable for such loss. As such, the general Danish tort law principles of negligence apply to the actions of the members of board of directors.

Moreover, the Danish Companies Act outlines the roles and obligations of management towards the company, supplemented by industry-specific legislation, such as the Financial Business Act (in Danish: *lov om finansiel virksomhed*). Failure by a member of management to comply with these regulations may in itself lead to liability.

The issue of management liability has been addressed in numerous legal cases, particularly in the aftermath of the financial crisis, offering a degree of protection for management. This is exemplified by Supreme Court decisions concerning Capinordic Bank, Eik Bank Denmark, ebh bank, and Løkken Sparekasse, which collectively establish that management should be allowed a wide range when it comes to business decisions, as long as no extraneous factors were considered, and that the decision was made on a solid and informed basis (the "business judgment" rule).

Decharge

The general meeting may grant management liability exemption for previous actions and/or omissions pursuant to the Danish Companies Act Section 364(2). Typically resolved at the annual general meeting, decharge is confined to information disclosed in the annual report and does not ensure immunity from liability in subsequent fiscal years.

An increasing number of prominent Danish companies have reintroduced decharge into their general meeting agendas. Nonetheless, the implications of decharge remain limited, as it does not preclude the possibility of legal proceedings if decharge was granted on the basis of inaccurate or incomplete information.

It is essential to note that decharge decisions exclusively influence the company's legal actions against management. It does therefore not preclude shareholders from pursuing legal action for individually incurred losses.

Indemnification of Management

In its guidance note, the Danish Business Authority concludes that there are no legal rules or practices prohibiting companies from implementing broad – or general – indemnification provisions in favour of its management.

In order to be considered valid, the decision to adopt management indemnity measures must, however, be in the interest and to the benefit of the company. If the general meeting decision complies with mandatory legal regulations, procedural requirements, the company's own by-laws, and respects the company's obligations towards creditors and other stakeholders, the decision may be in the company's interest. However, it is the general meeting's responsibility to assess whether indemnifying the board of directors serves the company's interest in each case. The company's interest encompasses not only shareholders' collective interests but can also include creditors' and other stakeholders' interests, with creditors' interests being particularly significant in insolvency situations.

The decision to adopt management indemnity must be based on the general meeting having received sufficient information to assess the exposure. For example, the Danish Business Authority has observed that several companies have resolved to indemnify board members (after exhausting any potential existing D&O-insurance). The general meeting may not be aware of the insurance terms, and thus the decision to indemnify the board is often made on an incomplete basis.

In this respect, the Danish Business Authority concludes that the general meeting must be presented with all significant information before it can adopt the indemnification. The individual information criteria vary from case to case as they largely depend on a company's size, activity, and other factors, however they must include (at least):

(i) An assessment of whether the indemnification is subordinate to a D&O-insurance;

(ii) A time limit;

(iii) A description of the activities covered;

(iv) A description of the behaviour covered, and

(v) A description of the damage and the injured parties covered.

The Danish Business Authority emphasises that indemnity provisions will not cover management for matters arising from gross negligence, intentional acts, or for criminal offenses. Furthermore, the company cannot waive future claims against the management if the company is likely to suffer direct harm.

Thresholds for decisions on indemnification of management

As mentioned above, it lies within the general meeting's power to adopt indemnity provisions when the board is the beneficiary. The resolution should, however, always be subject to a temporal limitation and can therefore be included in the remuneration policy, consequently making a simple voting majority to be sufficient (instead of a voting majority of 2/3 of the represented capital and votes cast if adopted in the articles of association).

The Danish Business Authority states, however, that an adoption in the articles of association is preferred to provide visibility and legitimacy of the indemnification scheme towards stakeholders such as investors, shareholders, and creditors. Moreover, the Danish Business Authority considers it more likely that the courts will accept indemnification schemes included in the articles of association as such indemnification was granted by a 2/3 majority.

Current practice – Nasdaq Copenhagen C25 Index

Despite the ambiguity around indemnification's legality and limited court examination, several of Nasdaq Copenhagen C25 index companies have already adopted the approach citing rationales such as:

(i) The liability insurance market for directors and officers has evolved, making coverage more challenging and costly to secure.

(ii) Attracting and retaining skilled and seasoned board members and executives is in the interest of the company and its shareholders. If liability insurance is unavailable on reasonable terms, indemnification becomes essential.

The analysis further reveals that indemnification clauses generally serve as a secondary measure to a company's D&O-insurance. If insurance coverage falls short, companies may be accountable for extra claims faced by a management member in some instances.

Our comments

Further clarification of certain aspects of the indemnification practice still remains as indemnification schemes ultimately need to be tried in court to be fully validated under Danish corporate law.

The guidelines presented by the Danish Business Authority regarding adoption of indemnification schemes align with our view on how the Danish Company Act should be interpreted, including as it relates to decisions in the company's own self-interest. Actually complying with the requirements at the general meeting set out by the Danish Business Authority could prove cumbersome, however, and the general meeting process may need to see significant changes in order to handle the level of detail needed to pursue indemnification as a separate agenda item, including providing the minimum specifics to the shareholders around (i) D&O insurance coverage, (ii) time limit, (iii) activity, (iv) behaviour, (v) damage and potential injured parties covered by a proposed indemnification (all as set out in the guidance note from the Danish Business Authority).

Going forward, our recommendation is that companies revisit their indemnification schemes to ensure that existing agreements align with the now further clarified practice. Companies which are yet to adopt indemnification schemes should consider the above prior to adopting or amending indemnification schemes.

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

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

Thomas Enevoldsen
Senior Associate
Thomas.enevoldsen@moalemweitemeyer.com

Nils Nissen Homann
Senior Associate
Nils.homann@moalemweitemeyer.com

This news piece has been produced in the English language only. Are you a client or a prospective client, and should you require a Danish version, please email us at news@moalemweitemeyer.com with a link to the article that you would like to request to receive in Danish, and we will attend to your request without undue delay.