Organhaftung
und
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Englische Zusammenfassung
der Dissertation

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Directors' and officers' liability and burden of proof

The chances of success of a directors' and officers' liability claim depend largely on the allocation of the burden of proof. Pursuant to Section 93 (2) sentence 2 of the German Stock Corporation Act (Aktiengesetz – AktG), companies benefit from a reversed burden of proof: The director does not only have to proof a lack of culpability. He or she also has to proof that there has been *no* breach of duty. This has come under heavy criticism, and yet there is a lack of in-depth discussion of the origin and the future of this unpopular provision. It is the aim of the submitted doctoral thesis to close this gap in research.

After an introduction to the legal framework (I.), the dissertation first traces the historical roots of the reversed burden of proof to the present day (II.). Once there, it undertakes a dogmatic classification (III.) and on the other hand analyses the practical challenges of such a far-reaching reversal of the burden of proof (IV.). After that it leaves the limits of German law and looks for suggestions in foreign legal systems (V.) for a final leap into the future, i.e. for a final legal policy recommendation (VI.).

Specifically, the dissertation brought the following results to light:

I.

1. Among all the instruments of evidence law outlined in the first chapter of the dissertation, the abstract and objective burden of proof has the greatest impact. Section 93 (2) sentence 2 AktG assigns exactly this abstract and objective burden of proof partially to the directors and officers. All subsequent questions, such as the question of a secondary burden of proof on the company's side, depend on the initial allocation of the abstract and objective burden of proof.

2. A closer look at the single elements of a breach of duty showed that the reversed burden of proof under Section 93 (2) sentence 2 AktG does not refer to either the duties of the director or his or her conduct as such. In this respect, according to general principles, the company (as the claimant) remains burdened with evidence. Conversely, the directors carry the burden of proof for the specific circumstances of their conduct (the circumstances which finally make their conduct appear as either rightful or wrongful).

3. The abstract allocation of the burden of proof, which is theoretically outlined in such a clear way, undergoes various loosenings at the level of the specific burden of proof and the burden of assertion. German legal figures like *prima facie* evidence and presumptions contribute to a certain flexibility, but also to uncertainty in the solution of the individual case.

II.

1. The second chapter's search for historical traces of the reversed burden of proof revealed a formal connection between the German Stock Corporation Act and the digests of Justinian. The link between the two proofed to be created by decisions of the *Oberappellationsgericht Lübeck* and the *Reichsoberhandelsgericht* with references to Roman law, which the *Reichsgericht* in turn applied to the liability of executive bodies.

2. On critical examination, though, this tradition of jurisdiction does not increase the historical legitimacy of the reversed burden of proof. According to the current state of research, the former recourse to the digests as a source of an *abstract* burden of proof appears just as vulnerable as the equation of contractors and directors based on the outdated mandate theory.

3. However, particular attention should be paid to the factual arguments in favour of a reversed burden of proof that have been put forward in the history of jurisprudence. A first approach aligns the burden of proof with the accountability of the mandate holder or director. A second approach considers the existence of a damage as a sufficient indication of a breach of duty. Finally, a third strand of reasoning is based on the conviction that the mandatary or the director himself is closest to the relevant circumstances of the alleged breach of duty. These arguments had to be kept in mind for the third, dogmatic chapter of the dissertation.

4. As a by-product of the historical analysis, it became apparent that the current distinction between breaches of duty on the one hand side and culpability on the other had formerly not fully developed. Under the influence of French dogmatics, which to this day unites both concepts in the notion of *faute*, the two terms were mostly used synonymously or in a synoptic manner of "care". The historical interpretation thus confirms the prevailing understanding of Section 93 (2) sentence 2 AktG as a uniform reversal of the burden of proof for both, culpability and breach of duty.

5. A change of perspective from jurisdiction to legislation revealed a prolonged reluctance to codify the reversal of the burden of proof. Although proposed by *Levin Goldschmidt* as early as 1882, the draft laws of the next fifty years left the field to jurisdiction.

6. The 1937 German Stock Corporation Act, too, would probably not have codified the reversal of the burden of proof if a bitter dispute had not flared up over the introduction of strict liability. Between the supporters and opponents of strict liability, a reversal of the burden of proof laid down by law presented itself as a conciliatory middle course. The pros and cons of the reversal of the burden of proof itself did not truly matter. The legislator has never reflected on this either in the context of the 1937 German Stock Corporation Act or later.

III.

1. The task of the third chapter was therefore to critically question the arguments developed in early case law in favour of a burden of proof on the directors' side. A first systematic orientation showed that Section 93 (2) sentence 2 AktG indeed reverses the regular allocation of the burden of proof, although there is astonishing disagreement about the burden of proof for a breach of duty.

2. Containing a reversal of the regular burden of proof, Section 93 (2) sentence 2 AktG triggers an increased need for justification. This need cannot be satisfied by the traditional reference to the accountability of the director. Rather, this argument turned out to be a disguised attempt to quickly transfer the director's burden of proof for the rendering of an owed performance (Section 362 (1) of the German Civil Code) to the claim for damages. At the same time, the third chapter showed in its course that no other German provision of stock corporation law or other civil law contains a comparably far-reaching reversal of the burden of proof as Section 93 (2) sentence 2 AktG.

3. As the following investigation showed, however, the provision does not only lack systematic clothing, but also a convincing inner core. Considerations on a possible indicative power of the damage as well as on the compensatory and preventive function of directors' liability hardly led further in the search for the substantive reasons of the provision. In this respect, the study focused on the director's greater proximity to evidence as a widely recognized reason for placing the burden of proof on them.

4. Traditionally, the company has had little means at its disposal to preserve evidence. However, the reversal of the burden of proof created an incentive for the director to document his actions. The director normally also had the best chances to find relevant evidence even in an abundance of physical files.

5. However, both aspects, the initial preservation of evidence and the later access to evidence, were subject to the change of time. With every use of modern means of work and communication, directors involuntarily document their behaviour, so that a secondary burden of proof on the directors seems sufficient as a further incentive for documentation. At the same time, digital information can be evaluated using data forensics, enabling the company to find any evidence itself. The director, on the other hand, is regularly no longer in office when a liability claim is issued and may have to enforce inspection rights first. The former *telos* of Section 93 (2) sentence 2 AktG has thus lost too much persuasiveness to further justify the most comprehensive reversal of the burden of proof under German civil law.

IV.

1. In the following chapter, selected practical problems subjected the reversed burden of proof to a litmus test. The first question was the fundamental meaning of the "possible" breach of duty, which the company has to put forward and prove according to case law. A ramble through various wordings in case law revealed that the expression concealed a secondary burden on the company to substantiate the breach of duty. Thus, the case-law is clearly striving for a case-by-case containment of the broad reversal of the burden of proof.

2. Next, the phenomenon of "double-relevant facts" revealed almost insoluble problems. These kind of facts are decisive for both, the breach of duty and the damage at the same time. Such facts often lead to a collision of the director's burden of proof for the compliance with all duties on the one hand with the company's burden of proof for the damage on the other hand. In particular, courts regularly impose the burden of proof for monetary inflows on the director, without differentiating between the occurrence of damage and its equalisation through advantages. Dogmatically, courts are moving on thin ice, but the applicable law simply does not open up any other way.

3. Furthermore, the chapter paid attention to the special situation of retired directors. For a director, the loss of office means an immediate and comprehensive loss of access to evidence. Even an extensively interpreted right of inspection on the basis of Section 242 of the German Civil Code is not sufficient to compensate for this loss. At the same time the claim to evidence of the presumed cartel owner, which was recently codified in the German Competition Act, is more horrifying than a model. It arouses therefore little hope that a similar codification in the law of directors' liability could provide for an effective remedy. It would therefore be logical to abolish the reversal of the burden of proof. At the same time, difficult questions (to be answered in different ways) about the applicability of Section 93 (2) sentence 2 AktG to retired directors on the one hand and their legal successors on the other hand became superfluous.

4. Incidental examination constellations put the reversal of the burden of proof to a final test of endurance. Since the liability and burden of proof provisions are to be understood as a unit, Section 93 (2) sentence 2 AktG is also applicable in principle if the director's liability is merely a preliminary question of other claims. Of course, the possibility of a teleological reduction remains unaffected.

5. The subsequent analysis of joint and several liability among members of governing bodies showed that the party opposing recourse must in principle relieve itself of the accusation of a culpable breach of duty pursuant to Section 93 (2) sentence 2 AktG. However, a different outcome may be indicated where the party liable for recourse is in

no way closer to the evidence than the recourse creditor. In determining the amount of recourse, a suspected breach of duty cannot weigh more heavily than a proven breach.

6. Similar questions arise if the director transfers his claim for indemnification against the D&O insurer to the company. In this situation, the court gets to examine the director's liability only incidentally. Even then, the claimant, in this case the company, would normally benefit from Section 93 (2) sentence 2 AktG. However, due to the limited evidence available to the insurer, a further correction seems appropriate. If the company does not want to lose the advantageous reversal of the burden of proof, it has to stipulate its continued applicability in the event of assignment in the insurance contract. Joint and several liability and assignment of the D&O indemnification claim thus provide living evidence of the complexity that Section 93 (2) sentence 2 AktG also carries into adjacent legal matters.

V.

1. The legal comparison of the fifth chapter provided a further mirror for the German regulation and drew attention to possible alternatives. Of the ten legal systems examined, only two assign the abstract burden of proof to the director with regard to the breach of duty, and even this is subject to reservation: In Portugal the reversal of the burden of proof is controversial and in Austria it is due to the introduction of the German Stock Corporation Act in 1938/1939.

2. By contrast, in Poland, Sweden, Spain and Switzerland (as well as after the EMCA), the abstract burden of proof lies with the company. This does not seem to cause any major difficulties in any of the countries. Only in Switzerland do some voices complain that the company sometimes lacks relevant information. Therefore, the Russian solution is particularly interesting, which contrasts the abstract burden of proof of the company with a kind of secondary burden of proof of director.

3. In England, little or no attention is paid to the allocation of the burden of proof. This may be due to the low standard of proof, which does not require the judge to be convinced of the existence or non-existence of a breach of duty, but rather to be satisfied on a balance of probabilities in the one way or the other. The latter also applies in the USA. This country's allocation of the burden of proof in the context of the Business Judgment Rule is – irrespective of all other differences – of great interest in Germany. In the USA, the burden of proof for a violation of the Business Judgment Rule lies first with the company. Only when the company overcomes this hurdle does the director have to prove the entire fairness of his actions.

4. The Netherlands is pursuing an even more dynamic approach. There, the burden of proof lies with the company at the outset, but the judge can pass it on to the director from an equitable point of view. A general reversal of the burden of proof, as in Germany, is, however, rejected. The Czech Republic has also deviated from the German solution in the recent past. In 2014, the legislator added a fairness clause to the regulation previously corresponding to the German reversal of the burden of proof, which allows the judge to allocate the burden of proof differently for reasons of justice.

5. Finally, France traditionally distinguishes according to the nature of the obligation concerned. The breach of an obligation of result must be proved by the company, whereas compliance with an obligation of effort must be proved by the director. With different terminology, this distinction has also made its way into Belgian and Italian law. While the Netherlands and the Czech Republic are striving for individual solutions, France, Belgium and Italy stand for an abstract and more generally differentiated approach.

VI.

1. Irrespective of the broad spectrum of possible regulations, there is only a narrow scope for a contractual regulation of the burden of proof between the director and the company. This makes legislative action all the more urgent, now that the need for reform has come to light several times in the course of the investigation.

2. The final chapter was therefore devoted to the options for legislative action. Among these, the abolition of Section 93 (2) sentence 2 AktG without replacement has recently found numerous supporters. Such a radical cut, however, threatened to unduly complicate the enforcement of directors' and officers' liability claims, even if an isolated presumption of fault (in the sense of culpability) remained.

3. A partial abolition of Section 93 (2) sentence 2 AktG towards a privileged treatment of entrepreneurial decisions or retired directors meant progress compared to the current legal situation. Both approaches, however, would be limited to narrowly defined areas and would in turn create new inconsistencies.

4. Completely alternative approaches, such as lowering the standard of proof according to the Anglo-American model or an opening for exceptions to fairness according to the Dutch or Czech model, also radiate a certain charm. However, they hardly fit in with the traditional rules on the burden of proof. Furthermore, their scope also went beyond the law on directors' and officers' liability.

5. Ultimately, the struggle to find a balanced solution solely at the level of the abstract burden of proof is not really surprising. After all, the abstract burden of proof must necessarily be allocated on either the one or the other side; in a situation without clear evidence (a so-called *non-liquet* situation) the judge still has to come to a decision in the one direction or the other, without any room for an intermediate solution. However, the flexible instrument of the secondary burden of proof may help to achieve a balanced solution already in advance of a *non-liquet* situation. The paper therefore concludes with the recommendation to move the abstract burden of proof for the breach of duty according to general rules back to the company, but to give the director a secondary burden of proof to substantiate compliance with all duties.