



Liabilities of Board Members Series-4: Board Members Liability Insurance in Turkey

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The Board of Directors ["**Board**"] is the main management body of a joint stock corporation. Accordingly, the Board members have extensive management and representation duties. Given that such broad duties inherently carry the same level of liability risk, legal liability of the Board members has always been a critical topic. [For detailed information on the legal liability of Board members and the liability lawsuit you can refer to our article: "Legal Liability of Board of Directors Members"]. The Board, as the representative and administrative authority, must be able to support the corporation in reaching the intended goal, fulfill the management duties without hesitation, and take independent decisions. Therefore, considering the magnitude of the liability risk, a warranty mechanism –insurance– to balance the increasing liability of the Board has been discussed for many years as an indispensable element in liability cases. Today, the "Board of Directors' Liability Insurance" ["**Board Members Liability Insurance**"] has already become as a widely used insurance type throughout the world, from United States to England and Continental Europe to Germany, Japan and Turkey. Issuance of this easily accessible insurance policy provides a significant assurance for the Board members.

This type of insurance, which is less known in our country's practice, but has an equally important place, has been introduced by the Turkish Commercial Code ["**TCC**"] under Article 361. This provision stipulates that the damage suffered by the company due to the fault of Board members while performing their duties can be insured. Also, in publicly held companies, the insurance must be disclosed if the coverage amount exceeds 25% of the company's share capital.

On the other hand, there is no regulation in the insurance legislation in relation to the policy terms and conditions of the Board Members Liability Insurance. Insurance companies generally issue special types of policies that insure against the specific types of risks faced by corporations. Precisely, due to that reason, it is very important how the policy terms, especially the recourse clauses, are determined in the policies.

Certain critical issues regarding the Board Members Liability Insurance will be discussed in this last article of our "Liabilities of Board Members" series.

Legal Nature of Board Members Liability Insurance

Board Members Liability Insurance policy examples, which are frequently used in practice, demonstrate that the policy is designed with special terms and conditions. Indeed, there is a wide range of circumstances which may lead the liability of Board members, who have an objective duty of care and therefore, can be held liable as a proxy. In other words, the Board members may face liability claims for many reasons. In this respect, each policy is designated specifically and provides insurance protection against the liability claims that may be brought forward due to the faulty decisions and/or negligence of the Board members.

As the significance of Board Members Liability Insurance increases throughout the world as well as in Turkey, the insurance coverage or policy exclusions are easily changeable depending on the circumstances set out in the policies. Although this may vary depending on the specifics of the policy, insurance companies generally accept to indemnify damages of the corporation, relevant official institutions, creditors, customers, competitors, employees, liquidators, and shareholders.

Policy Coverage

Before examining the scope of insurance coverage, several terms should be defined. Accordingly, the insurer is the party who enters into the policy with the insurance company and pays the premiums. The insured or the beneficiary means the person(s) protected under the policy in case of a loss or claim.

In the policies of Board Members Liability Insurance, the insurer is usually the corporation. Although rarely, the Board members may also be the insurer. In such cases, the Board member will become a policyholder, i.e., the insurer, and therefore, will have to pay the premiums. On the other hand, if the policyholder is the corporation, then the corporation will be liable for the premiums.

In liability insurance, it is of vital importance to designate the “insured” [beneficiary] party. In some cases, the insured is only the corporation itself against the losses incurred by the corporation as a result of acts or transactions of the Board members. Nonetheless, this type of policy would not provide required protection for a Board member. As such, should a Board member desire to eliminate his/her legal liability, then s/he should be designated as the insured party in the policy along with the corporation. Furthermore, directors, managers or officials, and employees can also be the insured party.

Again, subject to the specifics of each policy, the typical scope of policy coverage can be listed as follows:

- Indemnities covered by the policy and payments that the Board is legally obliged to make (such as company taxes or other public debts),
- Court expenses incurred due to a lawsuit initiated against the member,
- Expenses incurred due to investigations against the member,
- Compensation claims against the corporation in relation to securities,
- Administrative fines imposed on the member by official institutions,
- Legal assurance and official bailment expenses,
- All requests made directly or indirectly on behalf of the corporation by the bankruptcy officer or liquidator.

Recourse:

In policies where the Board member is the insurer, the insurance company will undoubtedly not be able to recourse to the Board member after making the insurance payment to aggrieved third parties or the corporation.

However, this situation may change in the policies where the insurer is only the corporation, and not the Board member. Hence, depending on the policy terms, the insurance company may take recourse towards the persons, organizations and Board members that have caused the damage. Having said that, it is possible to add clauses to the policy stating that the Board members cannot be subject to recourse in case of indemnifying the damages arising from their omission but not from willful misconduct. In this respect, in the policies where the Board members are not the insurer party, it is important to exclude the clauses which give rise to insurance company's right of recourse from the policy.

Policy Exclusions

As in every type of insurance, Board Members Liability Insurance policies contain various exclusions as well. Although this may vary in practice, damages incurred due to the member's willful breach of its duty owed to company is usually excluded from the insurance coverage.

Further, when we look at the application of this insurance in the world and in Turkey, claims for [i.] penal clauses agreed in the contracts, [ii.] liability for damages caused by products offered or works or other acts performed by the corporation, [iii.] environmental damages, [iv.] liability in a pending litigation or judicial procedure, [v.] physical injuries, and [vi.] penal fines imposed pursuant to the criminal laws are generally excluded from the scope of the insurance.

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