Directors and Officers Liability Insurance (D&O) contracted by the direct public administration in Brazil*

O contrato de seguro de responsabilidade civil para diretores e gestores na administração pública direta no Brasil

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ABSTRACT

This article aims to analyze the Directors and Officers Liability Insurance (D&O) contracted by the direct public administration in Brazil. In this

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context, an understanding of the underpinnings of civil liability insurance sheds light on the nuances of the D&O, whose beneficiaries are usually managers and public agents enjoying highdiscretion decisionmaking power. Hence, this study will demonstrate that if a government wishes to make efficient use of D&O, a risk management tool, it is necessary to apply not only the Economic Analysis of the Law and principles of corporate governance but also general principles governing the public administration in its transactions.

KEYWORDS

Direct administration — civil liability — Directors and Officers Liability Insurance (D&O) — corporate governance rules — economic analysis of the law

RESUMO

O presente artigo pretende oferecer uma análise sobre os aspectos relacionados com a contratação de seguros de responsabilidade civil para diretores e gestores públicos (D&O) pela administração pública direta no Brasil. Neste contexto, procederseá a uma investigação dos fundamentos do seguro de responsabilidade civil que, por conseguinte, permitirá esclarecer as nuances do D&O cujos beneficiários são diretores e agentes públicos que gozam de alta discricionariedade em processos decisórios. Assim, será demonstrado que, se um governo deseja utilizar de maneira eficiente o D&O, que é uma ferramenta de gerenciamento de risco, é necessária não só a aplicação da análise econômica do direito e de princípios de governança corporativa, mas também de princípios que regem a administração pública em seus negócios jurídicos.

PALAVRAS-CHAVE

Administração direta — responsabilidade civil — Directors and Officers Liability Insurance (D&O) — regras de governança corporativa — análise econômica do direito

Introduction

In a society where acts, facts and legal relationships tend to get more complex, assigning responsibilities becomes an increasingly imprecise science, subject to endless questioning, and if the law does not address this issue adequately, the result can be serious legal uncertainty and, consequently, major social instability.

This is today's reality, and the law has evolved a corresponding theory of liability that does not always require the person held liable to be the one who has caused the damage. Liability without fault is based, essentially, on a theory of risk that defines, in advance, conduct that is inherently risky and where liability is presumed, irrespective of any subjective observation as to who actually caused the damage. This legal convention subjects people in this situation to a series of precautions and safeguards not necessarily provided for in law, regulation or case law, since liability will not be ascertained subjectively on criteria of foreseeability, prudence or expertise, but simply because the risks inherent in the activity in question have been assumed.

This scenario, if not essential for the creation of insurance law, has made a major contribution to its evolution, with the many and complex hypotheses of civil responsibility leading people increasingly to search for solutions to help minimize it, so as to make managing risky businesses safer.

On the one hand, third party liability insurance exists as an effective management instrument in private law, and is widely used by large corporations whose performance in the market is directly affected by the level of safety of their activities and the decisions of their management. In public law, however, there is still much doubt as to its legality, especially in respect of Directors and Officers Liability Insurance (D&O), which is intended to cover the personal liability of senior managers in the public administration.

The aim of this article is to present, within an essentially dogmatic line of research, the specific characteristics of this type of insurance and the way the courts approach it in Brazil, making use, when necessary, of concepts from international doctrine to justify its existence and application; and then to consider in more detail the difficulties of obtaining D&O coverage for managers in the public administration, in particular taking into account the strict liability of the State and its right of recourse against agents that cause damage to third parties.

We shall undertake a bibliographic survey of domestic and foreign doctrine, and also research case law and legislation. A theoretical approach to the matter is essential, because the purpose of the article is intimately related to constitutional dogma. Nevertheless, the use of certain operating concepts proper to economic analysis and specialist literature permits an epistemological approach, in addition to a merely dogmatic one, offering fertile soil for the law to be transformed. The method used will be predominantly inductive, but with support from dialectics, since we shall be considering unfinished concepts which are still subject to change.

1. The insurance contract

1.1 The main rules for an insurance contract

The civil code[1] of 1916 defined the insurance contract in article 1.432 as "that by which one of the parties assumes the obligation to the other, against payment of a premium, to indemnify it for losses resulting from future risks defined in the contract". The current civil code[2], in article 757, leaves the definition practically unchanged, simply adding the need for legal authorization for one of the parties to act as insurer in contracts of this type[3].

The insurance contract exists to protect individuals and legal entities against risks. In our daily lives we are subject to the possibility of injury and loss. You can walk on an uneven surface and sprain your ankle. The owner of a bakery may suffer losses because of a power cut (for example: frozen food in the refrigerator goes bad). A large corporation may have to suspend production at a number of units because of higher prices on the international market for one of its raw materials. These are all illustrations of risks in

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1 BRAZIL. Law No. 3.071, of January 1, 1916. *Diário Oficial da União*. Brasília, DF, Jan. 5, 1916. Section I, pg. 1.

2 BRAZIL. Law No. 10.406, of January 10, 2002. *Diário Oficial da União*, Brasília, DF, Jan. 11, 2002. Section I, pg. 1.

3 It is important to note that "in Brazilian law, insurance was originally regulated by the Commercial Code, but its provisions were limited to maritime insurance. With the introduction of the Civil Code in 1916, the insurance contract was regulated as a standard document, in articles 1.432 to 1.476. In 1966, Decree-Law No. 73 regulated insurance transactions. The Civil Code of 2002 deals with insurance contracts in articles 757 to 802. For now there is no specific law governing insurance contracts in Brazil" (SOUZA, Bárbara Bassani de. Responsabilidade civil do segurador. *Revista da Faculdade de Direito da Universidade de São Paulo,* v. 109, Jan./Dec. 2014, pg. 747) (footnote omitted).

everyday life that we can rarely foresee. Sometimes we can take precautions to minimize these risks. An insurance contract is one of these precautions.

Still, for an insurance contract to be valid, it is necessary for the parties to act in good faith, which is one of the pillars of the new civil code. In this context, article 765 provides that "the insured and the insurer are obliged, in agreeing and executing the contract, to act with the strictest good faith and truthfulness, both in respect of the object of the insurance and of the circumstances and declarations related to it[4]".

Concerning the principle of good faith, article 766 of the Civil Code provides for severe consequences for failure to comply with it: "if the insured or his representative make inaccurate statements or omit circumstances that might affect the acceptance of the proposal or the amount of the premium, he shall lose the right to indemnity and shall still be liable to pay the premium due[5]".

Also in reference to good faith, article 769 of the Civil Code determines that "the insured is obliged to notify the insurer immediately upon becoming aware of any incident that might significantly aggravate the risk covered, failing which he shall lose the right to indemnity if it is proved that he acted in bad faith[6]".

1.2 Directors and Officers Liability Insurance (D&O) contracts

1.2.1 The context in which D&O contracts are issued

In view of all these provisions enshrining good faith, it is hardly surprising that civil liability insurance must also be founded upon good faith.

In the business world, good faith makes it possible for companies to arrange insurance for their staff, in particular their senior managers. The business environment has evolved considerably in recent years. Trade barriers have been removed, facilitating an increase in global trade.

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4 Brazil. Law No. 10.406, of January 10, 2002. *Diário Oficial da União*, Brasília, DF, Jan. 11, 2002. Section I, pg. 1.

5 BRAZIL. Law No. 10.406, of January 10, 2002. *Diário Oficial da União*, Brasília, DF, Jan. 11, 2002. Section I, pg. 1.

6 Ibid.

In this situation, companies have to safeguard themselves against possible risks in their operations. Following this line of reasoning, companies also started to realize that it would be a good idea to arrange civil liability insurance for staff in strategic positions, such as officers and directors.

These officers and directors have assumed more and more responsibility, and have to make highly complex decisions which may not achieve the expected results. And so risk management has become essential, so that companies can be free of uncertainty when they make their plans, and so achieve their goals and satisfy their shareholders.

Possibly the best way of managing these risks is to arrange insurance, attracting good managers and avoiding what is called "defensive management" which, in general terms, involves resources being diverted by managers who wish to minimize their civil liability risks, instead of being used to produce the desired corporate results. Protection for managers' personal assets gives them peace of mind and lets them act without excess caution, particularly if we take into account the fact that managing companies is, by nature, a risky business which can lead to losses, and that what the market needs is managers who are prudent but bold[7].

Officers and directors have often been taken to court by third parties who suffered losses due to decisions made by them, or subjected to administrative proceedings by market regulators[8]. The amounts involved can be substantial.

1.2.2 The D&O contract in Brazil

D&O started to be used in Brazil, still in a small way, at the end of the 1990s, by companies trading in American Depositary Receipts (ADRs), as a way of protecting themselves against possible claims for indemnity by third parties or by international investors against their managers or the company itself[9]. However it was only when the new Civil Code was enacted that D&O started to be used more widely in Brazil. We can safely say that:

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[7] LACERDA, Maurício Andere Von Bruck. *O seguro dos administradores no Brasil:* o *D&O Insurance* brasileiro. Curitiba: Juruá, 2013. pg. 94.

[8] In Brazil, we could mention the Securities Commission (CVM) or the Private Insurance Superintendence (SUSEP).

[9] Item I of article 1 of CVM Instruction No. 559, of March 27, 2015, defines Depository Receipts as "certificates issued abroad by a depository institution to represent securities authorized in specific regulations issued by the National Monetary Council (CMN), held in custody

> In line with the growth of this type of insurance in the Brazilian market, the regulations have included D&O insurance in the overall category of "liability insurance" and classified it as line "10", in Exhibit I to SUSEP Circulars No. 395/2009 and No. 535/2016. In spite of this, however, SUSEP did not at first outline the rules for this type of insurance, and so the rules for claim-based policies were applied, including the provisions of SUSEP Circular No. 336/2007. During this time, since there were no specific rules for D&O insurance, the insurers had more freedom to determine the terms of the policies, subject always to the overall rules for claim-based civil liability insurance. In view of this, some D&O policies provided coverage for fines imposed on managers. In 2008, the SUSEP Attorney General's Office for Corporate Affairs and Special Regimes issued an internal opinion to the effect that D&O insurance policies could not cover fines imposed on the insured, since this would "discourage non-compliance with the law", i.e. would reduce the disciplinary character of the fine imposed and cancel out the negative effects on a company's assets of conduct by a manager, discouraging it from adopting corporate governance practices. However it was only in 2012 that SUSEP started to act on this opinion, refusing approval of policies covering fines submitted to it for registration or renewal[10]. [footnotes omitted]

SUSEP has issued a number of circulars on D&O insurance, and the latest, No. 553, of May 23, 2017, is now in force. Articles 4 and 5 of this circular define it as civil liability insurance contracted on behalf of individuals currently or previously holding management positions in companies, to cover their liability for injury to third parties caused by negligent wrongful acts while in office, including reimbursement of indemnities they may have to pay under a final court ruling, arbitration award or out-of-court settlement agreed by the insurer[11].

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in Brazil". In the case of ADRs, the securities are issued by North American depository institutions.

10 CUNHA, Carolina Estarque da. *O seguro de responsabilidade civil de administradores à luz da nova regulamentação da SUSEP.* Dissertation (master's degree in law) — Pontifícia Universidade Católica, Rio de Janeiro, 2017. pg. 74-75 (footnotes omitted).

11 PRIVATE INSURANCE SUPERINTENDENCE. Circular 553, of May 23, 2017. *Diário Oficial da União.* Brasília, DF, 98th ed. May 24, 2017. Section 1, pg. 32.

D&O is based on the idea that managers have some independence in directing company business. In the meantime, there must be general rules of conduct to be observed in order to diminish the risk of damage to the company.

2. Rules of corporate governance

To this end, rules of corporate governance were introduced, to be obeyed by officers and directors of a company to keep it economically healthy and reduce the chances of lawsuits filed by third parties who may have suffered injury. As a result, a correlation exists between the powers granted to officers and the responsibility they assume. In relation to this, Bainbridge comments that "these values refer, respectively, to the need to preserve the board of directors' decisionmaking discretion and the need to hold the board accountable for its decisions[12]".

The rules of corporate governance arose in the United States and were subsequently adopted and adapted by a number of countries, including Brazil. The key objective is to encourage good management practices. Under our legal framework, the basics of corporate governance are contained in articles 153 to 157 of Law No. 6.404/1976 (the Brazilian Corporate Law)[13].

In brief, managers are duty-bound to be diligent and loyal and to report and avoid conflicts of interest. When these duties are observed, the manager's actions are known as "regular management actions".

From the duties established by the idea of corporate governance, we get the "business judgment rule", which is intended to define criteria and guidelines for the business performance of officers and board members, offering them more legal comfort and backing when taking decisions.

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[12] BAINBRIDGE, Stephen M. The business judgment rule as abstention doctrine. Los Angeles, Ucla, School of Law. *Research Paper*, No. 3-18, Jul. 29, 2003, pg. 2. Available at: <https://ssrn.com/abstract=429260>http://ssrn.com/abstract=429260. Accessed on: Apr. 18, 2019. Similarly, Cordeiro asserts that "the administrator who, when exercising the corresponding functions, fails to do his duty and thus causes damage, is civilly liable. The liability thus identified touches a sensitive chord in the management of companies. From the start it presupposes a determination — or determinability — of the duties of management" (CORDEIRO, António Menezes. *Da responsabilidade civil dos administradores das sociedades comerciais.* Lisbon: Lex, 1997. pg. 19).

[13] BRAZIL. Law No. 6.404, of December 15, 1976. *Diário Oficial.* Executive Branch, Dec. 17, 1976. Supplement, pg. 1.

Once abstract overall rules of conduct had been defined for company managers, the doctrine of abstention came into being, based on the idea "that, if there is no reason to think that a manager has failed to observe his duties of care and loyalty, there is no reason (for the court) to review the reasons which led him to make a particular business decision". [14]

Lacerda adds a further comment:

> There is a prevailing argument that the courts should abstain from analyzing the merit of decisions by managers when they have acted in accordance with the duties of loyalty and care expected of them. The principal basis for this argument is in the fact that, in business, many of the decisions made by managers, in addition to being risky by nature, cannot normally be assessed *a posteriori*, because they are the result of choices that are not in the legal domain, but are based on financial criteria or investment opportunities, denoting the existence of an incomplete contract[15].

Our explanations thus far are permeated with elements from the realm of economics. When this serves to justify the functioning of the courts, we are in the presence of the movement known as "law and economics", or, in simple terms, an economic analysis of law (EAL). This new way of looking at the law first appeared in the United States in the second half of the twentieth century. The central purpose of this movement is to undertake a new analysis of traditional dogma using a multidisciplinary approach. Ideas and concepts derived from economics can help the scholar resolve problems for which a purely formal analysis of the law is not sufficient[16]. The EAL will be important for a decision on whether D&O can be used in the public administration.

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[14] Maurício Andere Von Bruck Lacerda, *O seguro dos administradores no Brasil*, op. cit., pg. 67.

[15] Ibid, pg. 67.

[16] On changes in the EAL, see the following works, among others: COASE, Ronald H. The problem of social cost. *Journal of Law and Economics*, v. 3, pg. 1-44, Oct. I960; KORNHAUSER, Lewis A. A análise econômica do direito. *Sub Judice*, No. 2, pg. 43-70, Jan./Apr. 1992; and RODRIGUES, Vasco. *Análise econômica do direito* — uma introdução. Coimbra: Almedina, 2007.

3. D&O insurance arranged by the public administration

3.1 Analysis of the insurance from an infraconstitutional viewpoint

Now that we have outlined the typical characteristics of D&O insurance, the next step is to investigate whether the direct public administration can arrange such insurance, and this demands a study of the legislation governing public contracts in general and insurance contracts in particular, and of the different treatment given to the direct administration and the entities which are part of the indirect administration.

The public administration must hold a bidding process before executing a contract and comply with the provisions of Law No. 8.666/1993[17] and, in consequence, the constitutional principles applicable to the public administration.

The application of the Bidding Law must conform to the more lofty objectives that the public administration is aimed at, i.e. to improve the quality of life of the population as a whole. This is why there are a number of ministries, each with a mission in its specific area.

And this is why nowadays planning is essential in the public administration. Public managers must be able to deal with the challenges that reality presents them with. But it is a well-known fact that people in Brazil are very unhappy with the level of services provided by government. This demoralizes the administration and leads to the belief that everything coming from the public sector is inefficient and expensive.

So the Bidding Law must be looked at in a new light, so as not to hinder managers' performance. It is correct to say that:

> The current view of public contracting is based on the idea that the [bidding] process has only two phases: the bidding and the contract. This view needs to be revised, because it only partially reflects the phenomenon of public contracting and overlooks its most important dimension: planning, which is part of the internal phase that precedes the bidding and the contract. So the phenomenon of public contracting

[17] BRAZIL. Law No. 8.666, of June 21, 1993. *Diário Oficial da União,* Executive Branch, Jun. 22, 1993. pg. 8269.

> has been viewed only partially, even by the legislators. It is enough to see how it is dealt with in the current legislation (Laws No. 8.666/93 and No. 10.520/02) to see that this statement is correct. This view must be revised, because we have to see the full dimension of the contracting process[18].

If we see the Bidding Law in this new light, it is entirely possible to extract from it the authorization for the public administration to arrange D&O insurance cover.

If we look at article 6, section II, we read that insurance is an "activity intended to obtain a certain utility of interest to the Administration". In its turn, article 62, paragraph 3, section I, provides that "the provisions of articles 55 and 58 to 61 of this Law and other general regulations apply" to the insurance contract[19].

Note that Law No. 8.666/1993 aims at safeguarding the interests of the public administration in drafting insurance contracts. Even taking into account the fact that, initially, insurance contracts came from the private sector, the articles listed above show that, provided these articles are complied with, it is permitted for the administration to arrange insurance, in particular D&O liability insurance. This therefore complies with the principle of the supremacy of the public over the private interest.

In the Civil Code it is also possible to find a provision that allows the direct administration to contract D&O insurance: this is article 757, the main section of which reads "under an insurance contract, the insurer undertakes, against payment of a premium, to guarantee the legitimate interests of the insured, relative to any person or thing, against defined risks[20]". Note that the provision refers to "legitimate interests". In the case in point, the interest of the insured is to guard against any risks that may materialize precisely because of the complexity and uncertainty of the decisions they take due to their elevated position in the structure of the public administration. In this scenario, the insured's interest is legitimate and in line with legal precepts.

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18 MENDES, Renato Geraldo. *Lei de Licitações e Contratos anotada — notas e comentários à Lei nº 8.666/93*. Curitiba: Zênite, 2013. pg. 21.

19 BRAZIL. Law No. 8.666, of June 21, 1993. *Diário Oficial da União*, Executive Branch, Jun. 22, 1993. pg. 8269.

20 Brazil. Law No. 10.406, of January 10, 2002. *Diário Oficial da União*, Brasília, DF, Jan. 11, 2002. Section I, pg. 1.

In discussing D&O insurance, commentators must take into account the interaction between public law and private law. So much so that the supervisor of the Civil Code Review and Drafting Commission, Professor Miguel Reale, made the following comments on June 10, 1979:

> Paragraph 20. Lastly, I cannot fail to comment on the maintenance in the Civil Code of provisions relating to people and public assets. There is no justification for the view that the Civil Law is not the place for these matters. This is not a case of a privatistic concept of Administrative Law, which is far from the well-known positions of the author of this statement, but reflects, above all, an understanding of Philosophy and the General Theory of Contemporary Law, which maintain the distinction between Public and Private Law as two perspectives that order legal experience, considering them to be distinct but substantially complementary and even dynamically reversible, rather than two absolute, watertight categories[21].

If we consider the bodies that control the public administration, it is important to note that the Federal Audit Court (TCU) has already indicated approval for the public administration to arrange D&O insurance. In Ruling No. 3.116/2013, the TCU in plenary session decided as follows:

> The Justices of the Federal Audit Court in Plenary Session, having heard the views of the Rapporteur, AGREE:
> [...]
> 9.3. to inform Centrais Elétricas Brasileiras S/A — Eletrobras that:
> 9.3.1. contracting insurance where the policy includes coverage for indemnity or payment of sanctions applied by State bodies, as a result of negligent or intentional acts, in cases where it is proven that the precautions and legal measures that would be expected of the average man were not taken, offends the principles of morality and the supremacy of the public interest contained, respectively, in article 37, main section, of the Constitution of the Federative Republic of Brazil, and in article 2, main section, of Law No. 9.784/1999;

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[21] FEDERAL SENATE. *New Civil Code.* Exposure of reasons and text approved. Brasília, 2009. pg. 39.

> 9.3.2. contracting insurance to defend managers in administrative or court proceedings, where the policy includes coverage for the practice of manifestly illegal actions, contrary to the public interest, which are negligent or intentional, in cases where it is proven that the precautions and legal measures that would be expected of the average man were not taken, offends the principles of morality, legality and the supremacy of the public interest contained, respectively, in article 37, main section, of the Constitution of the Republic, and in article 2, main section, of Law No. 9.784/1999;
> [...][22].

Therefore, according to the TCU, D&O insurance can be obtained by the public administration provided that it does not cover "indemnity or payment of sanctions applied by state bodies, as a result of intentional or negligent acts, in cases where it is proven that the precautions and legal measures that would be expected of the average man were not taken" or "defense of managers in administrative or court proceedings, where the policy includes coverage for the practice of manifestly illegal actions, contrary to the public interest, which are wrongful or negligent, in cases where it is proven that the precautions and legal measures that would be expected of the average man were not taken".

The TCU ruling also makes it clear that the insurance policy may not provide indemnity for penalties applied by supervisory bodies in the public administration, such as the TCU itself. These premises, in the final analysis, safeguard the public interest relating to the exercise of the State's own powers, to the extent that insurance coverage may not be used to circumvent the power to discipline private citizens, and apply too to the public agent who intentionally or negligently fails to comply with his basic duties in law or regulation, or under internal governance rules.

It remains only to decide who is the "average man" referred to by the Court in its judgment. We think that this expression is related to the duties of diligence, loyalty, and the reporting and avoidance of conflicts of interest referred to in articles 153 to 157 of the Corporate Law, or in corporate governance regulations that the authorities may issue. An example of this latter situation is the Joint MP/CGU Normative Instruction No. 1, of May 10, 2016.

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[22] FEDERAL AUDIT COURT. *Appellate Decision 3116/2013-Plenary Session, Nov. 20,* 2013.

In discussing the subject of this article, it is relevant to quote the opening paragraph of article 3 of this normative instruction:

> Article 32 The bodies and entities of the federal Executive Branch must implement, maintain, monitor and review internal management controls, in order to identify, assess and manage risks that may affect the attainment of the government's objectives. The internal management controls are the first line (or layer) of defense of public organizations in achieving their objectives. These controls are operated by all the public agents responsible for activities and tasks which are part of the final macro-processes supporting the federal government bodies and entities. Defining and operating the internal controls must take into account the risks it is intended to mitigate and the objectives of the public organizations. Accordingly, *taking into account the objectives set by the bodies and entities of the public administration, and the risk arising from internal or external events that may hinder the attainment of these objectives, the internal controls must be put in place that are most likely to reduce the likelihood that such risks may arise, or that they affect the organization's objectives*[23]. [our italics]

It is clear therefore that, by following the rules of compliance, the administration will have a better chance of reducing the risks in its activities.

It must also be stressed that it is not only the body (ministry, department etc.) whose interests and values must be protected, but also the public agents that work there, as provided for in article 22 of the Joint MP/CGU Normative Instruction No. 1/2016:

> Risks and internal controls must be managed in an integrated manner, in order to establish a control and risk management environment that respects the values, interests and expectations of the organization and *of the agents that are part of it* and, also, of all the interested parties, in particular the citizen and society[24]. [our italics]

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[23] OFFICE OF THE FEDERAL CONTROLLER GENERAL; MINISTRY OF PLANNING, BUDGETING AND MANAGEMENT. Joint Normative Instruction No. 1, of May 10, 2016. *Diário Oficial da União*, Brasília, DF, 89th ed., May 11, 2016. Section I, pg. 14.

[24] Ibid.

One could argue that, with the enactment of Law No. 13.303/2016, known as the Law of State Companies, D&O would only be possible for the indirect administration, since paragraph 1 of article 17 of the law in question provides that "the statutes of the state company, mixed-economy company or their subsidiaries may provide for the arrangement of civil liability insurance for managers[25]". But this argument is bound to fail, not only for the reasons we have already outlined in favor of D&O for the direct administration, but also because this provision simply permits civil liability insurance to be used for the indirect administration and says that it is a useful tool enabling managers to take more audacious decisions.

3.2 Analysis of contracting the insurance from a constitutional angle

As to what can or cannot be insured, this certainly should not include willful misconducts, as this would violate the principle of administrative morality enshrined in article 37 of the Constitution, as well as the principle of good faith. The Superior Court of Justice has ruled on the illegality of coverage of willful misconducts. In REsp No. 1.601.555 it ruled as follows:

> SPECIAL APPEAL. CIVIL. CIVIL LIABILITY INSURANCE FOR COMPANY OFFICERS AND MANAGERS (D&O INSURANCE). POLICY RENEWAL. RISK ASSESSMENT QUESTIONNAIRE. FALSE INFORMATION SUPPLIED BY THE INSURED AND THE TAKER OF THE INSURANCE. BAD FAITH. CONFIGURATION. LOSS OF RIGHT TO INDEMNITY. INVESTIGATIONS BY THE CVM. INSIDER TRADING. INTENTIONAL ACT. PERSONAL ADVANTAGE. MANAGEMENT ACT. DE-CHARACTERIZATION. NO COVERAGE. 1º The argument is limited to defining (i) whether information was intentionally omitted from the application form for renewal of D&O insurance and (ii) whether indemnity is payable under a policy in the event of insider trading.

[25] BRAZIL. Law No. 13.303, of June 30, 2016. *Diário Oficial da União,* Brasília, DF, 125th ed., Jul. 2016. Section I, pg. 1.

2º The penalty for the insured who acts in bad faith by making untrue statements or omitting information that might influence the acceptance of the proposal by the insurer or the premium amount is the loss of the insurance coverage (articles 765 and 766 of the Civil Code). In addition, the information omitted or provided in disagreement with the facts must be related to the cause of the claim, i.e. must be linked to the actual intensification of the risk (Statement No. 585 of the Seventh Civil Law Journey).

3º According to the case documents, the information supplied by the taker of the insurance and the insured in the insurance renewal proposal gave a false impression of the company's situation at the time and led the insurer to assess the risk incorrectly. The intentional omission of the events under investigation by the CVM supports the sanction of losing the right to coverage.

4º The material facts omitted should have been reported even before the contract was renewed, because the duty of good faith imposed on the insured is "to notify the insurer, immediately on becoming aware of it, of any incident likely to materially intensify the risk covered, or otherwise lose the right to indemnity, if it is proven that they acted in bad faith" (article 769 of the Civil Code).

5º The purpose of D&O (Directors and Officers) Insurance is to cover the risk of losses caused by officers, managers and board directors acting negligently (SUSEP Circular No. 541/2016). Preservation not just of the assets of the individual managers (the insured), which encourages innovative corporate practices, but also of those of the company arranging the insurance and its shareholders, since they will be reimbursed for any losses.

6º D&O insurance policies cannot cover intentional acts, in particular if they are intended to benefit the manager himself, and this avoids a serious decrease in the level of diligence by the manager or the assumption of excessive risk, jeopardizing both the company's compliance activities and its good corporate governance practices. Application of articles 757 and 762 of the Civil Code.

7º Insider trading is understood to be any dealing by an insider (officer, manager, director or similar) in company securities to the benefit of themselves or a third party, based on material information not yet released to the public. It is a practice that is damaging to the capital markets, to investors and to the company itself, and there must be

effective prevention of the undue use of such privileged information (articles 155, paragraph 1, and 157, paragraph 4, of Law No. 6.404/1976 and 27-D of Law No. 6.385/1976).
8º D&O insurance only covers negligent acts by officers, managers and directors in the course of their work (management activities). In other words, fraudulent or dishonest acts for personal benefit, or intentional actions which damage the company and the capital markets, such as insider trading, are not covered by the insurance.
9º Appeal to the Federal Supreme Court denied[26].

Similarly, the contracting of D&O by the direct administration does not offend the principle of administrative morality. In this context, Moreira Neto argues that what we should use as a criterion for administrative morality is the public purpose, which should be understood by analyzing the motives and the purpose aimed at or achieved through the act[27]. The public purpose, in this case, is precisely the greater efficacy of state activities, providing more legal certainty for managers to take assertive decisions and thus not paralyze the public machinery. The primary public interest is in this way prioritized and served.

It is true that the public administration has strict liability, under article 37, paragraph 62, of the Federal Constitution. Having to pay for a loss suffered by a third party, it has the right of recourse against the public agent who caused the loss. Under this system, Federal Supreme Court (STF) case law holds that the injured party can only sue the public company, not the agent who caused the loss. In the event of proven intention or negligence, the public company may subsequently sue the agent.

If we analyze the scheme of strict liability of the State, as it is described in the Constitution, we find no incompatibility with the contracting of D&O insurance for agents of the direct administration. Here we need to consider the key constitutional principles involved. On the one hand, we have the principle of strict liability of the administration. On other, the principle of efficiency,

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[26] SUPERIOR COURT OF JUSTICE. Appeal to the Federal Supreme Court No. 1601555-SP, Judgment Feb. 14, 2017, Rapporteur Justice Ricardo Villas Bôas Cueva, 3rd Review Panel of the Superior Court of Justice, v. 246, Apr./Jun. 2017, pg. 497.

[27] MOREIRA NETO, Diogo de Figueiredo. Moralidade administrativa: do conceito à efetivação. *Revista de Direito Administrativo,* Rio de Janeiro, v. 190, pg. 7-8, Oct./Dec. 1992.

which holds that the State must maximize the quality of its activities in order to achieve the primary public interest[28].

In this situation, contracting D&O insurance is clearly related to the principle of efficiency, since it permits public agents who hold high office in the direct administration to make decisions more freely and courageously, thus boosting the effectiveness of the state machine. Naturally the direct administration would bear the cost of the premium, and in return it will have the advantage of providing services more efficiently. Talented professionals will be encouraged to take senior positions in the direct administration.

In this context, we must invoke the principle of reasonableness or proportionality to decide the impasse between applying the principle of efficiency and the strict liability of the State, since this principle will allow us "to ascertain whether legislative and administrative activities have not caused losses to society that are noticeably greater than the benefits obtained[29]". There must be, then, "a properly structured relationship between the means and the end[30]"; otherwise, reasonableness will not exist. In this case, the means is the contracting of D&O insurance and the end, an improvement in the quality of the services provided by the State. The conclusion, then, must be that it is reasonable to use this type of insurance to achieve the primary public interest.

Another factor is that the Federal Constitution and the rule of law as a whole grant certain positions or functions guarantees so that they can be properly exercised. There are plenty of examples of this: the lifetime tenure and functional independence of judges and public prosecutors; the immunity of state representatives and senators for their opinions and votes in exercising their mandate; the budgetary independence of the public defender's office, and so on. In the case of D&O insurance, there is the benefit it provides for public agents holding high office in the direct public administration, so that they can carry out their duties adequately. So the insurance is contracted not to give an advantage to a specific person, but to offer guarantees for important positions or functions in the public administration so that they can be exercised properly.

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[28] Once again we see the influence of the EAL in resolving legal impasses.

[29] CRISTÓVAM, José Sérgio da Silva. *Colisões entre princípios constitucionais:* razoabilidade, proporcionalidade e argumentação jurídica. 2nd print run Curitiba: Juruá, 2007. pg. 251.

[30] ÁVILA, Humberto. *Teoria dos princípios:* da definição à aplicação dos princípios jurídicos. 18th ed. revised and updated São Paulo: Malheiros, 2018. pg. 207.

4. The importance of discretionary powers for public agents

To appreciate the significance of the assertion that D&O insurance can be contracted in the direct public administration, it is important to highlight the role of the discretionary authority of public agents in making decisions and practicing administrative acts.

The public administration is governed by the principle of legality, which has constitutional status conferred on it by article 37 of the Federal Constitution. Based on this principle, every administrative act derives from a relationship of submission to the law, and this means that such acts require advance legal authorization, unlike the situation in private law, when it is sufficient not to act contrary to the law.

It is equally certain, however, that not all administrative action is totally in line with the law, in every aspect and element. There are certain acts which, under the law itself, require the exercise of discretionary powers, in other words that fall within certain parameters where the law gives the public agent some level of autonomy to assess whether it is opportune and convenient to take action in accordance with this discretion. In other words, although the law may not admit the existence of purely discretionary acts, with no legal support, given their level of arbitrariness and the impossibility of control by the courts, it does however allow the public administration, within the limits of legal control, to exercise a *"certain amount of liberty* [...] in order to satisfy, in a specific situation, the purpose of the law[31]". It is precisely in this area of liberty that we find the merit of the administrative act, which is legally controlled on the basis of constitutional principles of legality, purpose and reasonableness, since it is on this basis that there is justification for the discretionary powers of the judgments of convenience that orbit controlled action. In this sense, according to Bandeira de Mello[32]:

> If the law always regulated the administrator's behavior absolutely, there would always be the same solution, even in different situations where decisions could not be safely listed in advance, simply because the reality of the empirical world is many-sided and has countless

[31] MELLO, Celso Antônio Bandeira de. *Curso de direito administrativo.* 34th ed. São Paulo: Malheiros, 2019. pg. 1.021.

[32] Ibid.

> variables. Thus in many cases a *stagnant* normative rule would often lead to undesirable results.

According to the argument of Afonso Rodrigues Queiró[33], the existence of a discretionary area in administrative action, due to the impossibility that the legislator could catalogue in law all the situations requiring state action, is justified by the separation of powers, since the total suppression of discretionary action would lead to administrative action by the legislator, exceeding the essentially abstract and general nature of the legislative function:

> There is, however, a limit for determining the concepts used in the regulations, beyond which no legislator as such can go without changing from the abstract to the individual, from abstract regulations to individual orders: which would involve abandoning the purpose of the rule of law itself.

In certain aspects of the decision-making spectrum of the public administration, there is ample margin for discretion by the public agent, particularly in view of the need to thoroughly analyze the risks involved in activities subject to external factors that it is hard to measure. It is precisely in this context of uncertainty arising from the risks directly related to the discretionary parameters of the decisions made that it is justified to arrange D&O insurance for managers in the direct public administration, provided that it is borne in mind that the ultimate purpose of such a contract is to guarantee the interests of the administration, with any protection being provided to the manager being simply a byproduct.

Given this premise, we find that, as a rule, insurance contracts signed by the administration are intended to cover losses borne by the State, without necessarily protecting the liability of the public agent who caused the damage. Accident insurance, for example, obeys this logic, and this allows the insurer to seek reimbursement from the public agent responsible in the case of a claim.

Defining the breadth of insurance coverage is crucial in determining the principal amount of the contract and the premium. Determining whether a policy covers the manager's risks or only those of the State is a measure to

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[33] QUEIRÓ, Afonso Rodrigues. A teoria do desvio de poder em direito administrativo. *Administrative Law Review*, v. 6, pg. 57, 1946.

be taken into account by the administration when arranging the insurance, precisely because, if there is an increase in the price, the administration must be able to show that it is advantageous in terms of legitimate public interest.

Particularly in cases of administrative acts involving large sums of public money, the guarantee to the players involved derives from legal actions by the public agents, and only in exceptional cases might negligent or intentional wrongful acts be involved. Nonetheless, the liability of the State is always strict, and so it can also derive from a legal act. Such cases are ideal for describing public interest in insurance coverage for agents. After all, if they act within legal parameters, any liability attached to these agents for action that it not unreasonable would be exceptional: it would justify an increase in the premium to protect them against liability for incalculable amounts, and would free them up to a point to assume the risks inherent in their functions. In other words, insurance coverage for managers can be justified as a measure to ensure maximum efficiency of public policy by optimizing the instruments at the manager's disposal, to operate safely in a high-risk business environment.

Conclusions

This study does not attempt to list hypotheses for contracting Directors and Officers (D&O) insurance in the public administration, since this would require a wide-ranging study of state functions and a list of those which use wider margins of discretion and so involve more risk for the administration and the public agents themselves.

However, from what we have seen, it is possible to identify parameters for the appropriate use of such contracts and thus outline standard procedures for determining when and how this insurance is viable and advantageous for the public administration, and not only for the agents that benefit from it.

From an analysis of the risks, the first conclusion we reach is that D&O is a service principally for those in senior management positions in an organization, public or private, since these are the people involved in high-risk, complex decisions and business, where the results are unforeseeable. In the public administration, these risks may be diverse in nature, but are usually estimated carefully because of the large sums of public money involved.

The normative treatment of D&O insurance by the sector regulator in Brazil has provided a favorable business climate for its use, in the private or the public sector, provided that, in the latter case, the principles governing

administrative contracts are obeyed, based on the supremacy of the public interest.

As a rule, for D&O coverage to be possible, the insurer will require the contracting organization to have strict standards of governance, in order to limit the range of discretion the manager has in exercising his functions. But, beyond the controls of the regulator and the self-regulation of the sector itself, which relate chiefly to the duties of diligence, loyalty and good faith in business relationships, there are additional conditions to be observed, as outlined in this study, if this instrument is to be used by the public administration, especially the direct administration.

First of all, it is essential that the insurance does not cover administrative sanctions applied by the contracting party, since in this case the State would be protecting the agent against the police power or its own disciplinary power, thus defeating the aim of the administrative self-regulation enshrined in law and the Constitution.

Secondly, and as a result of this, it is obligatory that the insurance does not restrict its coverage to the liability of the public agent, but that it always covers, above all, the strict liability of the State and its right of recourse which is also assured by the constitution. For this purpose the coverage must be at least identical to that provided for the agent.

Lastly, the insurance cannot cover willful misconducts by the agent, because of the governing law, the principle of morality and the other principles of public administration. So only negligent acts should be covered, and the parties can agree a definition of such acts, depending on the price and the public interest identified during the internal tender or direct contracting phase.

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