

D&O Insurance Briefing Document

Directors and officers have a duty to exercise due diligence in overseeing the activities of the organization that they serve. They are required to act in good faith and in the best interest of the organization. Directors and Officers insurance provides important protection from costly litigation.

Directors have these basic duties:

“To act honestly, in good faith, in the best interests of the organization and to exercise the care, diligence, and skill of a reasonably prudent person.”

1. **Duty of Honesty:** To tell the whole truth (this does not mean breaking board confidence or unity/solidarity, and this duty does not end when your term ends)
2. **Duty of Loyalty:** Directors must at all times act in the best interests of the organization. This means placing the interest of the organization before your own, avoiding all real, perceived and potential conflicts of interest.
3. **Duty of Care:** To take great care in decision-making and oversight based on the reasonable person test (What would a reasonable person, with the same skills and experience, given the same information have done in this case.) (For example, there is a precedent in the Canadian courts that ruled “Directors MUST assure a corporate information and reporting system is in place and the board MUST consider it adequate. Further The system should be timely, accurate, and include information to allow for informed judgements about compliance with law and business performance.” So this would be a “reasonable person” standard for board oversight of information reporting.)
4. **Duty of Diligence:** Directors must act within the scope of the organization, within applicable rules and laws. This includes being diligent about being informed of the organization’s governance processes, rules and laws in order to ensure compliance with them.
5. **Duty of Skill:** Directors are not expected to be an expert in all things related to their board work, but, if you are you are expected to use it for the benefit of the organization (for example an accountant must use their skills in accounting, a lawyer their legal skills, and HR professional those skills, etc.)
6. **Duty of Prudence:** Directors must be able to demonstrate that they have carefully, deliberately, cautiously worked to foresee a course of action – they are not liable for honest mistakes, but they must be able to demonstrate prudence.

Directors and Officers may be liable for:

- Failure to fulfil their statutory duties as outlined above.
- Failure to act as stated under a statute. For example, if a statute requires directors to file a report or maintain certain records, and these reports and records are not maintained, then the director may be liable for an offence under that statute.
- Non-compliance of the organization with a statute. For example, directors may be liable for mismanagement, financial losses, wrongful dismissal, employee discrimination or failure to remediate environmental damage.

It is also important to note that:

- Directors can be held personally liable.
- Ignorance is not a defense.
- Resignation is not necessarily a defense.
- Board indemnity may not be enough.
- Directors may be liable for non-performance.

7 Core Aspects of an Issue that the Court will Consider in its Decisions:

1. The qualifications of directors
2. The significance of the action (materiality)
3. The information that was available at the time
4. The amount of time that was available to make the decision
5. The available alternatives
6. Did any director(s) belong to a special interest group that stood to benefit
7. Is the director a consultant to or on contract to the organization (in a conflict of interest)

What Types of Claims Should I be Concerned About?¹

Claims against directors and officers generally fall into two categories: bodily injury (physical harm) and non-bodily injury (non-physical harm, like discrimination or termination). The majority of claims are for bodily injury. Your general liability insurance normally covers board members, subject to policy terms and conditions, for claims arising out of bodily injury and property damage.

Directors & Officers liability insurance only covers non-bodily injury claims. Non-bodily claims include employment-related claims and mismanagement of funds, environmental damage, etc.

Employment practices like termination and discrimination are the largest exposure in these types of claims. If you have a small, friendly staff, and feel unlikely to have employment claims resulting in a lawsuit, you might not think it necessary to carry D&O insurance. However, when employees feel they have been wronged and are angry, they may file a claim even if it is baseless. At that point, you will have to hire lawyers. Your D&O then becomes a legal defense policy.

Fear of non-bodily injury lawsuits would be one reason to have D&O insurance. Although there are very few reported cases, that doesn't mean that claims have not been filed and then either settled out of court or dropped.

Why Do I need D&O Insurance?²

The **personal liability** of a Director and/or Officer of an organization is **unlimited**, whereas an organization's liability is limited. When a claim or allegation of wrongdoing arises, a Director's personal assets are at risk. It is a common misconception that a Director can expect his or her company to provide indemnity.

¹ Source: <http://www.npccny.org/info/oi2.htm>

² Source: <http://www.tldallas.com/d-and-o-why-do-you-need/>

Directors are increasingly being held personally responsible for the **management decisions** made during every working day. Claims brought against individuals can threaten both the personal wealth of individual directors & officers and the financial viability of the organization in question.

Only in limited circumstances are organizations obliged to indemnify their directors for wrongful acts. Many companies' articles of association specifically stipulate that the directors and officers will be indemnified in certain situations. This does not necessarily provide directors and officers with complete protection, as their company may **not be able to indemnify** them, perhaps because:

- it has insufficient funds. Many claims made against directors are from investors and creditors and arise when the company is insolvent
- it may not be permitted by its articles of association to do so in certain situations
- it may be prevented from doing so in certain situations by the provisions of the Acts it is incorporated under

Even where a company can and does indemnify a director for a personal liability, who will make good the loss to the company? A D&O policy will.

The purpose of Directors & Officers Liability insurance is to provide **protection to directors and officers** of a company for defence costs and legal liability incurred for claims and prosecutions against them in their role in the company. This includes the representation costs in investigations of them by regulators and other authorities.

Traditionally only larger companies have purchased D&O insurance. However the Directors of any sized organization require the same protection, particularly as their responsibilities become more onerous from both **increasing regulation and third party awareness** of their duties.

Allegations of **wrongful acts** can come from a wide range of sources. Investigations into the activities of the organization could come from the government (e.g. Health and Safety; CRA,) a regulatory body or a trade association. Employees or former colleagues could bring allegations. Directors can be held **accountable for the actions of others**, so while a Director may not have committed a particular act, the actions of a subordinate can have ramifications for the Director.

The Directors' & Officers' Liability Policy is designed to provide financial support. It provides for defence costs for investigations, costs involved in appearing in court and legal costs to fight various forms of allegations, involving any of the Directors.

Does D&O Insurance Cover Illegal Acts Committed by the Director or Officer?³

Intentional illegal acts or illegal profits are typically not covered under D&O insurance policies; coverage would only extend to "wrongful acts" as defined under the policy, which may include certain acts, omissions, misstatements while acting for the organization. Due to exclusions and as a matter of public policy, coverage is not provided for criminal fraud.

³ Source: http://en.wikipedia.org/wiki/Directors_and_officers_liability_insurance