

Corporate Law

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Liability Insurance Policies for Directors and Officers – A Checklist of Matters to Consider

Directors and officers face a wide and growing range of potential personal liabilities in the course of carrying out their duties. A directors' and officers' liability insurance policy (or "D&O policy") can help protect against these risks. D&O policies are negotiable and policy terms and conditions can vary materially. The following is a brief outline of certain issues that directors and officers should consider when reviewing their D&O policy.

Types of Coverage

- **In addition to "Side A" and "Side B" coverage, does the policy also provide "Side C" coverage?**

Most policies offer two types of coverage: "Side A", which covers directors and officers personally for non-indemnified claims, and "Side B", which reimburses the corporation for the costs of indemnifying directors and officers. In addition, many policies offer "Side C" coverage, which covers claims made against the corporation itself.

- **Is there protection against the risks associated with sharing the policy among the directors and officers and the corporation in the case of "Side C" coverage?**

To protect against the risks that coverage may be exhausted, the corporation may consider:

- purchasing "Side A only" and/or "Side A Difference in Conditions (DIC)" excess coverage (i.e., meaning additional insurance for the benefit of the directors and officers only); and
- including a "priority of payments" clause in favour of the directors and officers.

- To the extent there are excess policies, do these policies "follow form", such that coverage would be extended in accordance with the same terms and conditions as the primary policy?

Expiration of the Policy

- **When does the policy expire?**

D&O policies are typically sold for one-year terms on a "claims-made" basis, which means that coverage will only apply to claims made during the policy period, regardless of when the wrongful act giving rise to the claim occurred. More specifically, a policy is most commonly provided on a "claims-made and reported" basis, where claims must not only be made, but reported to the insurer, during the policy period.

- **Does the policy provide the option to purchase an "extended discovery period"?**

In the event that the policy is not renewed, extended discovery coverage provides for a further period of protection (usually 12 months) for claims arising within the policy period, but discovered during the extended reporting period.

- **Is the extended discovery period only available where the insurer chooses not to renew or terminate the policy?**

If possible, the extended reporting period should also be available where the insured decides not to renew or terminate coverage.

Who is Covered

- **How are the terms "director" and "officer" defined?**

- Are all past, present and future elected or appointed directors and officers of the corporation covered?
- Is coverage afforded to individuals acting as "de facto" or foreign equivalent directors and officers of the corporation?

- **Should coverage be extended to all fiduciaries?**

- **Are the directors and officers of the corporation's subsidiaries covered?**

- What constitutes a subsidiary for the purposes of coverage? Does it cover non-incorporated entities such as limited partnerships? Does it cover directors and officers who are nominees of third parties?

- Does the policy include the directors and officers of subsidiaries acquired after the commencement of the policy?
- **Is there protection in the event of death or legal incapacity?**
 - Does the policy extend to the heirs, legal representatives, estates and legal assigns of the insureds in the event of their death or legal incapacity?
- **Does coverage only apply to directors and officers in their capacity as directors and officers?**
 - Does coverage extend to a director or officer acting as an advisor or consultant to the corporation?

Scope of Coverage

- **What constitutes a “claim”?**
 - Do informal allegations made against the directors or officers constitute a claim?
 - Is a claim required to be in writing?
- **What types of claims are covered?**
 - Is coverage limited to claims based on negligence, or does coverage extend to intentional and deliberate conduct?
 - Are regulatory investigations and enforcement proceedings covered?
 - Are administrative, civil and arbitration proceedings covered?
- **Does the definition of “loss” include coverage for fines and penalties?**
- **Are statutory liabilities covered?**

For example, directors may be personally liable for:

 - unpaid employee wages and vacation pay; and
 - unremitted employee source deductions, Canada Pension Plan and Unemployment Insurance premiums, as well as income taxes withheld on payments to non-residents and sales tax.
- **What types of damages are covered?**
 - Are punitive or exemplary damages included?
 - Are damages resulting from both judgments and settlements covered?
- **How are defence costs covered and advanced?**
 - Does coverage extend to full legal, accounting, adjusting and investigative costs? Are these applied to reduce the policy limit?

Policy Exclusions

- **What types of claims are excluded from coverage?**

Common exclusions include claims arising from:

 - the specific intention or conduct of the individual, such as fraud, wilful misrepresentation, dishonesty or the obtaining of a personal benefit to which the director or officer was not legally entitled;
 - bodily injury or property damage;
 - environmental damage or pollution;
 - matters which are uninsurable at law;
 - insider trading;
 - claims existing prior to the commencement of the policy;
 - allegations made by one insured against another insured (also known as the “insured vs. insured” exclusion); and
 - violations of pension legislation or common law by fiduciaries of any pension, profit sharing or other employee benefit plan or trust.
- **Can the policy exclusions be restricted?**
- **Are exclusions based on the misconduct or dishonesty of a director or officer subject to a full severability clause?**
- **Can the insurer deny coverage for alleged misconduct or dishonesty?**

Ideally, coverage should only be denied where the misconduct or dishonesty is proved by final adjudication or there is an admission of liability.
- **How restrictive is the “insured vs. insured” exclusion?**
 - Does it provide a full defence costs carve out?
 - Does it contain carve outs for claims brought outside of the U.S. or Canada?
 - Does it contain a carve out for derivative actions brought against the directors?
 - Does it contain a carve out for claims made by former directors of the corporation?
 - Does it contain a carve out for claims made by a trustee in bankruptcy (or administrator, monitor, examiner or rehabilitator)?
 - Does it contain a carve out for employment practice matters?

- Does it contain a carve out for claims for contribution and/or indemnity?

Defence of a Claim

- **Who controls the defence of the action? Who selects defence counsel?**
 - Is there a “duty to defend” on the part of the insurer (i.e., is the insurer required to defend the directors and officers in litigation commenced against them)? How expansive is the duty?
 - Has the insurer reserved the right to approve defence expenses and be associated with the defence where the insured controls the defence of the action?
- **Can settlements or compromises be made without the consent of the insurer?**
- **Does the policy address how defence costs will be allocated (for example, where a claim includes both insured and non-insured aspects, or involves insured and non-insured parties)?**
 - Is a set percentage or pre-determined formula provided?
- **How will defence costs be allocated where a claim is made against the directors and officers of the corporation and the corporation jointly?**
 - Should priority be given to losses associated with the wrongful acts of the directors ahead of the indemnification costs of the corporation?

Cancellation and Rescission

- **Can the insurer cancel coverage at any time upon notice to the insured?**

This right may be removed where the policy allows the introduction of a “non-cancellation” clause.
- **Does the policy afford protection against rescission (for example, if the insurer attempts to rescind the policy based on misrepresentations in the policy application or financial statements accompanying the policy application)?**
 - Does the policy include a severability clause that exempts innocent insureds from rescission of the policy based on misrepresentations made or known by other insureds?
 - Is there a provision stating that the policy is “non-rescindable”, at least with respect to “Side A” coverage?

Special Circumstances

- **Directors and officers may be particularly vulnerable in the case of insolvency, a change of control as a result of a merger, acquisition or IPO, or retirement. Does the policy afford protection against these risks?**

In anticipation of such risks, directors and officers should consider:

- purchasing separate insurance;
- purchasing run-off insurance;
- arranging for non-cancellable insurance for a specified period of time; and/or
- ensuring that limits and breadth of coverage will be maintained or renewed for a specified period of time by the applicable board or corporation.

Dispute Resolution

- **Is there an affirmative alternative dispute resolution clause with respect to disputes between the insurer and the insured?**

Consideration should be given to whether it would be preferable to provide for the resolution of disputes by arbitration rather than by mediation and/or court proceeding.

The foregoing is not meant to be an exhaustive list of matters to consider when assessing your D&O policy. Documentation should be reviewed with the guidance of qualified professionals, as D&O policies are highly complex and will differ from insurer to insurer.

Please contact Franci Kussner or any member of the Goodmans Corporate Securities Group to discuss your Directors’ and Officers’ Liability Insurance Policy.