

Understanding D&O Liability: Managing Your Exposure

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Goodmans^{LLP}



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About Goodmans

Goodmans is recognized as one of Canada's leading business law firms offering market-leading expertise in specialties such as mergers and acquisitions, corporate finance, securities, corporate/commercial, banking and finance, private equity, REITs and income securities, tax planning, restructurings, litigation and commercial real estate. Founded in 1917, Goodmans has offices in Toronto and Vancouver with over 200 lawyers.

Goodmans provides a complete range of legal advice and representation to domestic and foreign business clients ranging from entrepreneurial businesses to multinational corporations, financial institutions, pension funds and governments across a wide range of industries.

Our lawyers are consistently recognized by leading industry arbiters, and in various surveys of clients and peers conducted by *Lexpert*, *Lexpert/American Lawyer Media*, *Chambers and Partners*, *Practical Law Company*, *Euromoney*, *International Financial Law Review*, *Law Business Research* and *Best Lawyers in Canada*. According to *Chambers and Partners*, as Canada's 21st largest law firm, Goodmans ranks solidly first in Canada on the proportion scale with over 20% of our lawyers recognized as the best in their fields.

Below is a sampling of our recent accolades:

- The *Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada* (2011 edition) lists 22 Goodmans partners among the leading Canadian lawyers excelling in 16 practice areas of law.
- The *Canadian Legal Lexpert Directory 2011* recognizes 40 Goodmans lawyers as being top-tier in their fields and leaders in 26 distinct areas of law.
- Chambers Global's *Guide to the World's Leading Lawyers 2011* ranks 41 individual Goodmans lawyers among Canada's finest. Goodmans' Restructuring/Insolvency Group stands alone as Number 1 in Canada for the 10th consecutive year and the Corporate M&A, Real Estate and Telecommunications practices are also ranked top-tier.
- In 2008 and 2009, Goodmans was named "National Law Firm of the Year for Canada" at *International Financial Law Review's* Americas Awards.
- *PLC Which Lawyer? Yearbook* ranks Goodmans in their top category in capital markets and restructuring and insolvency and "highly recommended" for banking and finance, construction, corporate real estate, corporate mergers and acquisitions, dispute resolution, private client, private equity/venture capital, tax and telecoms and media.
- *International Financial Law Review* 1000 ranks our M&A and insolvency and restructuring practices top tier and also recognizes our strength in capital markets and bank lending.
- *The Best Lawyers in Canada 2012* ranks 54 Goodmans lawyers across 27 practice areas, as among the best lawyers in Canada.
- *American Lawyer Media's 2010 Go-To Law Firm for the Top 500 Companies* guide selected Goodmans as a "go-to" law firm for financial service companies in the area of Canada.

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Presents...

**Understanding D&O Liability:
Managing Your Exposure**



Panellists



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Understanding Directors' and Officers' Legal Obligations

- **Corporate Framework**
 - Role and Responsibilities of the Board of Directors
 - Statutory limitations of responsibility/liability
 - The sanctity of limited liability and exceptions
- **Functions of the Board of Directors**
 - Appoint management and evaluate their performance
 - Manage or supervise the management of the business and affairs (not the day-to-day business operations)
 - Must retain ultimate control (limitations of shareholder authority)
 - Except in specific circumstances, no bright line between duties of board and senior management

Sources of Duties

- **There are three main sources that establish the duties, potential liabilities and standards for directors:**
 - Governing Corporate Statutes (OBCA, CBCA)
 - Other Federal or Ontario Statutes and Regulations
 - Taxation
 - Securities
 - Environmental
 - Employment
 - Criminal
 - Bankruptcy and insolvency
 - Common Law

Standards of Performance

- **Duty of Loyalty**

- A director must act honestly and in good faith with a view to the best interests of the Corporation
- Directors have a duty to:
 - Avoid conflicts of interest (and disclose and properly address those that arise)
 - Avoid abusing their position to gain personal benefit
 - Maintain the confidentiality of information they acquire by virtue of their position

- **Duty of Care**

- A director must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances
- Directors must act on informed basis after due consideration of the relevant materials and appropriate deliberation:
 - No rubber stamp
 - Objective standard
 - Time commitment / preparation / process

The Business Judgment Rule

- Where a board has made a business decision honestly, prudently, in good faith and on reasonable grounds, the courts should not second-guess the judgment of the directors
- Court will consider:
 - Procedures implemented
 - Processes followed
 - Informed and reasonable decision

Director Indemnities

- **Statutory Framework**
 - Limitations and restrictions
- **Contractual Indemnities**
 - Typical provisions
 - By-law versus indemnity agreements
- **Limitations (actual and practical)**

Best Practises for Managing Risk

- **Importance of Risk Management**
 - For company
 - For board
- **Identification of Risk**
 - Understanding the business and what risk means in context of business
 - Whose responsibility – management, board, shared?
 - Processes to identify risk – organization, timing, reporting
- **Identification of Risk Appetite**
 - How is risk being assessed, risk/reward being measured
 - Alignment of interests
- **Assessing Management’s Understanding of Risk and Response Planning**

Best Practises for Managing Risk (cont'd)

- **Specific Practises**
 - Location of risk oversight
 - At company level
 - risk officer, internal audit
 - At board level
 - Audit committee, specific risk committee, general board function
 - Governance considerations – benefits of independence in the risk identification and management function

- **Whose risk**
 - Board or Company

Best Practises for Managing Risk (cont'd)

- **How to Manage Personal Risk as a Board Member**
 - Attend all board meetings
 - Keep personal notes of meetings – for what purpose, risks
 - Review all minutes of meeting when received
 - Regular reports on risk areas, including from audit committee and auditors
 - Insist on liability insurance and indemnification
 - Insist that minutes record any conflict disclosure made by a director and a director's abstention or dissent is recorded
 - Read all relevant materials and make independent and informed decisions
 - Practices and procedures for statutory payments and notify directors when the company is unable to make such payments
 - Consider ILA when appropriate

D&O Insurance Matters to Consider

- **Type of Coverage**

- Side “A”

- Covers directors and officers for claims not indemnified by the corporation (i.e., in the case of insolvency or where corporate statute or corporation’s by-laws prohibit indemnification)

- Side “B”

- Reimburses the corporation for the costs of indemnifying the directors and officers

- Side “C”

- Covers the corporation itself

D&O Insurance Matters to Consider (cont'd)

- **Who is Typically Covered**

- All directors and officers, present, past, elected and appointed
- Individuals acting as “de facto” directors and officers
- Fiduciaries
- Directors and officers of subsidiaries
- Advisors and consultants

D&O Insurance Matters to Consider (cont'd)

- **Scope of Coverage**
 - Nature of Claims
 - Civil
 - Regulatory / administrative
 - Preliminary investigations
 - Fines and penalties
 - Definition of “Wrongful Act”
 - How broad is the definition of “Loss”?
 - Defence costs, including advancement

D&O Insurance Matters to Consider (cont'd)

- **Exclusions**

- **Basic Exclusions**

- Fraud, wilful misrepresentation, dishonesty or obtaining personal benefit;
 - Bodily injury or property damage;
 - Intentional torts (e.g. defamation);
 - Environmental damage or pollution;
 - Insider trading;
 - “Insured v. Insured”
 - Claims existing prior to the commencement of the policy

- Restricting the exclusions and particularly the “insured v insured” exclusion
 - Severability clause

D&O Insurance Matters to Consider (cont'd)

- **Defence of a Claim**
 - Duty to defend
 - Control of action, settlements or compromises
- **Dispute Resolution**
 - Is arbitration necessarily preferable to litigation?

Questions?

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Corporate Law

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.



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Profile

Sheldon Freeman is a partner at Goodmans and has developed a leading practice in corporate finance, mergers and acquisitions and securities law. He is recognized for his successes in completing sophisticated transactions with efficiency and precision, and has a reputation for resolving complex issues in a practical manner. Sheldon is also known for his regular involvement in high-profile transactions and expertise in corporate governance. He has been instrumental in the development of Goodmans' REITs and Income Securities practice group and is particularly accomplished in structuring and implementing cross-border transactions.

Sheldon's strong corporate and securities law practice and significant expertise in completing a wide range of multi-faceted transactions has also provided him with numerous opportunities to act on behalf of both underwriters and issuers in IPOs and subsequent offerings.

Sheldon also has built a substantial general corporate practice, advising various clients on issues ranging from formation to shareholder disputes and liquidity events. He is placed in the top tier of his peers in terms of his exposure to complex, high-profile proxy contests, public take-over bids and other merger and acquisition transactions, many of which were highly contested.

Representative Transactions

IPOs and Subsequent Offerings

- Keystone North America Inc., Stephenson's Rental Services Income Fund, Four Seasons Hotels Inc., New Flyer Industries, GMP Capital Corp., RioCan REIT and Calloway REIT

Merger and Acquisition Transactions

- Stephenson's Rental Services Income Fund, Miramar Mining Corp. Four Seasons Hotels Inc., Schneider Corporation, Centrefund Realty Corporation, Revenue Properties Company Limited, Trojan Technologies Inc., combination of CPL Long Term Care REIT and Retirement REIT, Canadian Tire Corporation, Limited, Salter Street Films and Canadian Medical Laboratories Limited

Sheldon returned to school after several years in the corporate world and completed his law degree in 1995. He joined Goodmans the same year.

Education

Wilfrid Laurier University, B.A. (Political Science), Diploma in Business Administration, 1987
Osgoode Hall, LL.B., 1995

Year of Call

1997 Ontario



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Profile

Francy Kussner is a partner in the Litigation Group at Goodmans. Her practice covers a wide range of areas, including real estate litigation, banking and insolvency litigation, contractual disputes, insurance issues, professional negligence litigation, shareholder and partnership disputes and numerous other commercial matters. Francy received her undergraduate degree from York University and her LLB from Osgoode Hall Law School. Francy frequently appears before the Superior Court of Justice and the Ontario Court of Appeal. She has also appeared before the Federal Court of Canada and various tribunals, including the Ontario Human Rights Commission and the Ontario Securities Commission. Francy has extensive experience in Alternative Dispute Resolution, including mediations and arbitrations.

Francy has published articles in the “Abstract Page” (April 2003) and the “Commercial Litigation Journal” (2004, Volume X, No. 3); has spoken at an Institute for Professional Development Inc. symposium on “Major Business Agreements – Practical Negotiating and Drafting Strategies” (December 2003) and has co-chaired a conference for the OBA on “Everything You Always Wanted to Know About Mortgages (and were afraid to ask)” (March 2004). She has also chaired conferences for The Law Society of Upper Canada on “Safeguarding Real Estate Transactions” (November 2005, November 2007, November 2009).

Education

York University, B.A., 1984
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Professional Affiliations

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Profile

Gale Rubenstein is a partner at Goodmans and member of the firm Executive Committee. She practices in the areas of commercial insolvency and restructuring, with emphasis on financial institutions, both domestic and international, and pension and employee issues in insolvencies, in various industries for a diverse group of clients. Gale has been the author of numerous papers. She sits on the advisory board of the Canadian Lawyers Liability Assurance Society and is a member of the board of directors the Canadian Insolvency Institute and of Hydro One Inc.

Gale is identified as a leading practitioner of restructuring and insolvency law by legal publications including the *Canadian Legal Expert Directory*, *Chambers Global Guide to the World's Leading Lawyers*, *IFLR 1000*, *The Best Lawyers in Canada*, *Euromoney's Guide to the World's Leading Insolvency and Restructuring Lawyers* and *Guide to the World's Leading Insurance and Reinsurance Lawyers*, PLC's *Which Lawyer?* and *Restructuring and Insolvency Handbook* and Law Business Research's *Who's Who International of Insolvency and Restructuring Lawyers*.

Education

Osgoode Hall, LL.B.

Professional Affiliations

Insolvency Institute of Canada
INSOL International
International Women's Insolvency and Restructuring Confederation