

Corporate Governance and D&O Insurance - Which is the Cart and which is the Horse?

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Corporate Director

Oversight Role of Directors

- oversee management of business and affairs
- prescribed standards of care – a fiduciary duty and a duty of care
- obligation to *“act honestly and in good faith with a view to the best interests of the corporation”*
- *“exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances”*

KNOW WHICH HAT YOU HAVE ON!

Directors have 3 basic duties:

- Duty of Diligence (Duty of Care): Act reasonably, in good faith, in the organization's best interest
- Duty of Loyalty: Place the interest of the organization before your own.
- Duty of Obedience: Act within the scope of the organization, within applicable rules and laws.

Legal Liability

- Directors may be liable for:
 - Failure to act as stated under a statute. eg. if a statute requires directors to file a report or maintain certain records, and these reports and records are not maintained
 - Non-compliance of the organization with a statute. eg. liable for mismanagement, financial losses, wrongful dismissal, employee discrimination or failure to remediate environmental damage.

Important to note:

- 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 nonperformance.

Risk management

- Provide awareness training in negligence and liability to all directors and officers.
- Ensure directors are aware of:
 - risks associated with being a director of the organization;
 - statutory and civil liabilities;
 - specific directors' obligations;
 - other rules associated with the organization's business for which directors may be liable due to acts or omissions of the organization;
 - And other responsibilities (including understanding finances and knowing the organization and its charter).

Risk management

- Ensure there is no conflict between the duty owed to the organization and the director's self-interest.
 - Avoid outside employment/business that may interfere with or influence the organization's duties.
 - Handle confidential and sensitive information carefully (prevent release of information).
 - Follow guidelines on the appropriateness of public statements (i.e., what and when information can be released).
 - Do not accept gifts, favours or services relating to company duties.

Risk management

- Establish a formal information reporting system. Generally, a director is entitled to rely on information provided by officers or employees/volunteers of the organization, unless the director knows that relying on the officer/employee/volunteer is unadvisable.
- Speak up. Directors should have a clear understanding of all the activities in the organization and should question anything that is unclear. Directors should also clearly communicate their decisions.

Risk management

- Document decisions and how they were made.
- Work closely with legal representatives in making decisions.
- Implement a “whistle blower” policy.
- Implement a director’s indemnification policy that clearly states the rights and obligations of directors and what protection is provided to them by the organization.

D&O not the only form of corporate coverage applicable to directors

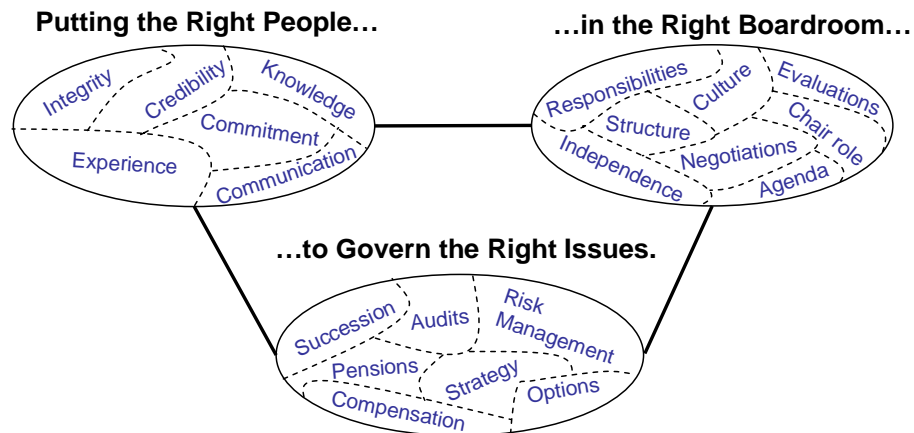
- General liability (for bodily injury or property damage)
- Employment practices liability
- Fidelity liability
- Fiduciary liability
- Institutional errors & omissions coverage

Directors should work with management to satisfy that D&O insurance is part of a overall corporate risk management process.

D&O policy

- Almost always placed and paid for by the corporation itself
- Applies only to directors & officers positions with that corp. or its affiliates, or outside boards upon which the individual sits at the request of the corporation
- D& O policies are complex documents that need to be interpreted with care and with the help and guidance of knowledgeable professionals
- Should schedule a regular review as part of the responsibility of risk management

Value-added role of directors



David Beatty and Tim Rowley, Director's Education Program, Rotman School of Management,
University of Toronto, 2008

Before Joining a Board-Know the Company you keep

■ Perform due diligence

- Personal backgrounds of fellow Board members & senior management
- History of the company and financials
- Challenges/opportunities
- Time commitment and expectations
- D&O policy & indemnification/insurance coverage/insurance claims

Oversight Role of Directors

- emerging company directors often wear many hats
- even though nominated by a particular shareholder – may not act contrary to fiduciary duty (inside (employee) directors adhere to same standard as outside directors)
- ensure that other relationships do not compromise director responsibilities
- recognize that you have liability from many sources
- best protection is to be diligent (as well as indemnification and insurance)
- remember fiduciary duty and standard of care are prescribed standards (in law)

References and further reading

- Canadian Coalition for Good Governance (www.ccgg.ca)
- RiskMetrics (www.riskmetrics.com)
- Institute of Corporate Directors (www.icd.ca)
- Canadian Institute of Chartered Accountants (www.rmgb.ca)

Thank you

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- Corporate Governance and D&O
Insurance

Which is the Cart and which is the
Horse?

- Tyler Finch
- Chubb Insurance Company of
Canada
- May 12, 2010



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1. Policy 101
2. Exposures
3. Key Cases
4. Underwriting Considerations



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- **Policy 101**



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Why D&O Insurance?

- Coverage for the day-to-day decisions that a Board of Directors may make:
 - Acquire/divest assets
 - Merge corporations
 - Hire/fire key personnel
 - Negotiate key contracts
- **A “traditional” D&O policy = protection for the personal assets of the director or officer**



- Indemnification
 - Articles of incorporation
 - By-laws
- Suppose a director or officer is not indemnified?
 - Personal liability



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Personal Liability

- Director is not indemnified when:
 - Board votes to withhold indemnity
 - It is illegal for the Company to indemnify
 - Company is unable to indemnify



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How the Policy Works

- Clause 1 / Side A
 - The Director or Officer is not indemnified by the company
 - Payment is made on behalf of the Director or Officer
 - No deductible is applied



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How the Policy Works

- Clause 2 / Side B
 - The Director or Officer is indemnified by the company
 - Payment is made on behalf of the company
 - The corporate deductible is applied



- Clause 3 / Side C
 - Entity Coverage for Securities Claims
 - Payment is made on behalf of the company
 - Deductible Applies
 - Depletion of limits



- Claim
- Insured
- Wrongful Act
- Defense Cost
- Loss



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What constitutes a D & O Claim?

- **Claim**
 - a written demand for monetary damages
 - a civil proceeding commenced by service of a complaint or similar pleading
 - a criminal proceeding commenced by return of an indictment
 - a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document

Who Does the Policy Cover?

- **Insured Person**
- Past, present and future Directors and Officers
- Heirs, estates and legal representatives of covered Ds and Os; coverage can be extended to Managers, Employees, and Spouses as co-defendants
- Also Consider:
 - The Organization
 - Spouses
 - Employees



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- **Wrongful Act**
- Provides protection against “Wrongful Acts” or alleged “Wrongful Acts”
 - Wrongful Act
Any error, misstatement, misleading statement, act, omission, neglect or breach of duty committed, attempted or allegedly committed or attempted, by an Insured, individually or otherwise in his/her insured capacity.



- **Loss**
 - Usually has two parts: defence costs and damages (judgments, settlements)
 - Many definitions exclude fines or penalties imposed by law, punitive and/or exemplary damages, multiplied damages and matters deemed “uninsurable” under the law pursuant to which the policy is construed (intentional conduct)
 - Many also exclude Investigation/evaluation expenses

What does the policy exclude?



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- Matters covered under other policies
 - BI/PD, Pollution, ERISA/Fiduciary
- Matters uninsurable under the law
 - Insider trading, illegal remuneration, fraud
- Matters too precarious to underwrite
 - I v I, Prior Notice



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Other Considerations

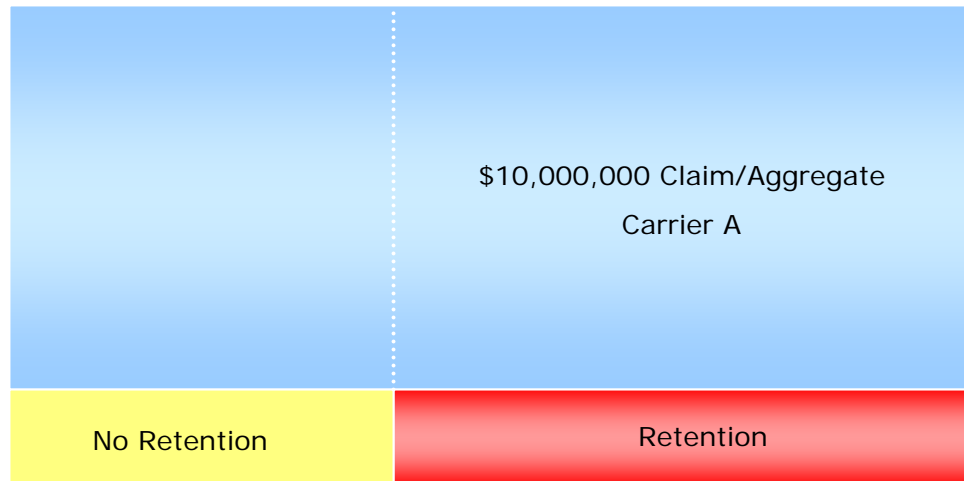
- Severability
 - Exclusions
 - Application
- Notice of Claims or of Potential Claims

- Clause 1 / Side A Coverage coming back to the forefront
- Solutions:
 - Clause 1 / Side A only policy
 - Side A Excess Policy
 - Side A DIC Excess Policy
 - Personal Directorship Policy



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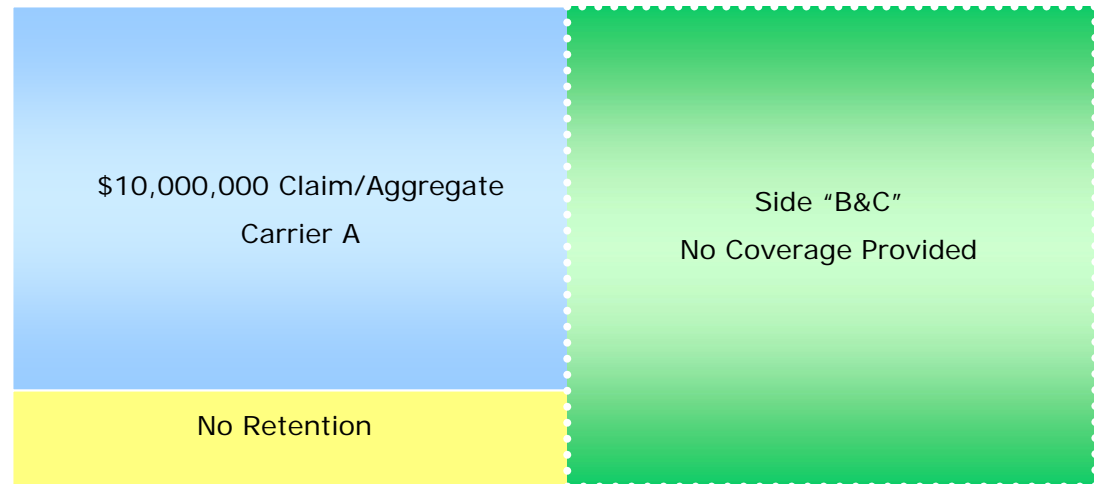
Traditional Structure



Clause 1 / Side A Only Policy



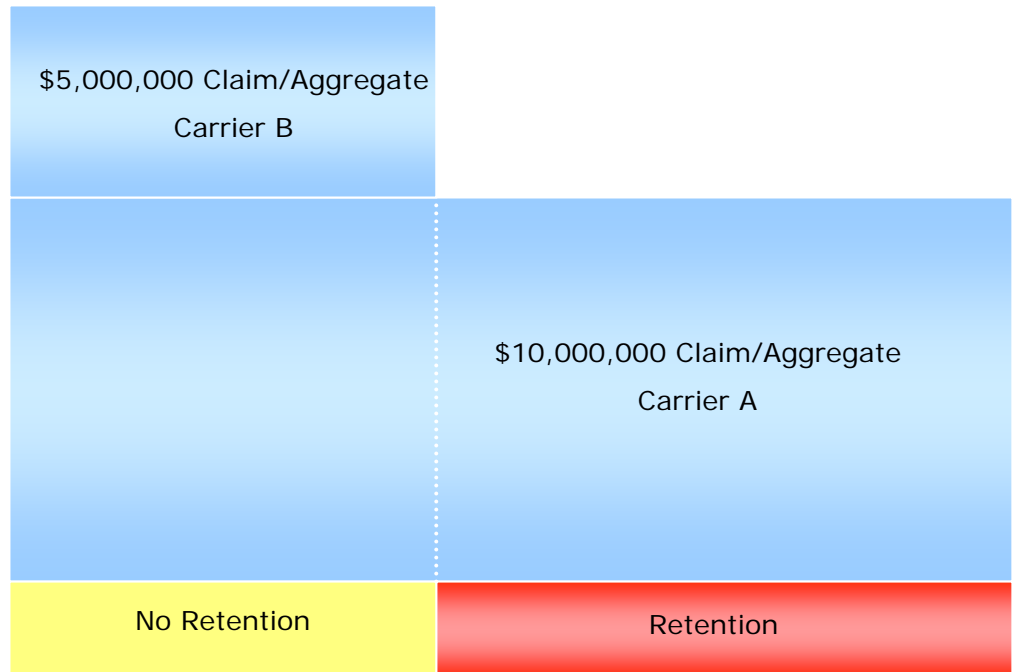
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Clause 1 / Side A Excess Policy



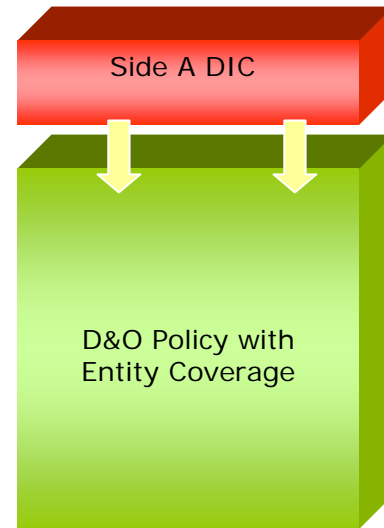
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Side A vs. Side A DIC Coverage



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- **A claim typically has :**
- ***Covered and uncovered matters***
- ***Covered and uncovered parties (the D's & O's and the Entity)***
- ***Covered and uncovered capacities (eg. Officer v. In-house counsel)***
- ***Can be predetermined***
-



- Exposures



- Exposures in Canada:
- Statutory Liabilities
- Oppression Remedy
- “Bill 198” and Secondary Market Liability



- Corporate obligations imposed on directors when a corporation becomes insolvent – not imposed on officers of the entity
- Due diligence defense not often successful – sometimes successful with respect to remittances but usually ‘strict’ liability imposed
- Joint and several liability imposed on the board



- Debts not exceeding up to 6 months wages for each employee for services performed for the corporation
- Accrued vacation pay for each employee up to 12 months
- Other corporate remittances:
 - GST, PST
 - Withholding taxes
 - CPP, EI



- **Oppression Application (S.241, CBCA; S.248 OBCA)**
- Complainant can bring an application for order where the powers of the directors of the corporation are, have been or are threatened to be exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor or director or officer



- Legislated mechanism has been in place since the 1970s Federally and in all provinces
- Brought by a complainant which includes current or former shareholders, directors, officers and any other person who in the discretion of a court is appropriate



- Court powers very broad, including:
 - Orders restraining conduct, appointing a receiver, regulating the corporation's affairs, directing an issuance of shares, appointing new directors and so on
 - Awarding damages



- *Dylex*
 - Claim by Trustee in Bankruptcy of Dylex against former directors and officers arising out of the share sale of Dylex which resulted in the purchaser imposing limitations on the payment of supply creditors whilst the sale was pending
 - Dylex ultimately went bankrupt and supply creditors were not paid
 - First case that allowed a trustee in bankruptcy to bring an oppression remedy
 - Also the first significant case where creditors successfully used the oppression remedy
- BCE bondholder claim



- Bill 198, Ontario, received royal assent on 12/02, statutory civil liability provisions proclaimed in force on December 31, 2005
- Grants investors in the secondary market a direct right of action against corporate directors and officers for negligent misrepresentations in documents and public statements and for not disclosing material changes in a timely manner (I.E. post IPO)



- No need to prove reliance on a document if misrepresentation was made
- Limits on damages in absence of allegation of fraud 5% of market cap or \$1 million
- Allowed to bring civil action as well if allegations of fraud, no restrictions on amount of damages in a civil action



- Started slow but number of cases have increased to 16
 - CV Technologies, AIG, Gammon Gold, Arctic Glacier Income Fund etc...
- IMAX first to be certified, currently under appeal
- Nova Gold Resources - \$28M settlement in 02/10



- Peoples Department Store v Wise
- Danier Leather



Peoples Department Store v. Wise

- Statutory fiduciary duty/duty of loyalty (con't)
 - “The various shifts in interests that naturally occur as a corporation’s fortunes rise and fall do not, however, affect the content of the fiduciary duty under Section 122(1)(a) of the CBCA. At all times, directors and officers owe their fiduciary obligations to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.” (emphasis added): *Peoples v. Wise, supra*
- Note: BCE creditor action



- CEO and CFO found personally liable.
 - failed to conduct a more complete investigation which a reasonably prudent person in their position would have conducted
- Overturned on Appeal
- Upheld by the Supreme Court of Canada
- Business Judgment Rule



- Main form application - warranty statement
- Latest financial information
- Canadian Securities and SEC filing info / prospectus (if applicable)
- Copy of by-laws and indemnification procedures
- Meeting with underwriters



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- Questions?