Assurances

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Résumé de l'article

L'assurance responsabilité civile des administrateurs et des dirigeants remonte, semble-t-il, aux années trente. Elle a connu, depuis son origine, des modifications importantes et l'on peut penser, si l'on en croit l'auteur de cet article, que des avenues s'offrent encore, visant à améliorer le contrat d'assurance. M. Francis Style examine la nature de la garantie en relation avec les besoins très particularisés que peuvent avoir les sociétés elles-mêmes et leurs administrateurs. Il discute également des exclusions et de certaines conditions. Nous le remercions de son article qui pose, en termes neufs, une réflexion fort intéressante sur l'assurance en titre.

The directors and officers' policy – past, present and a possible future

by

Francis Style[1]

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Insurance policies are in general the source of much confusion, but the directors and officers' policy form probably causes more misunderstanding and confusion than all the others combined. From an obscure beginning some 45 years ago as a revolutionary but simple concept of protection, the D&O policy has evolved into a hybrid coverage as various extensions have been added, while at the same time a number of new exclusions seems to defeat the original purpose of the insurance. It is quite possible that developments in the next 5 or 10 years will make the term "directors and officers" quite inadequate as a description.

The story of the D&O policy really began with the financial collapse of the U.S. stock market in 1929, which heralded the great depression of the 1930s. One result of this was the American legislators' desire to tighten up control of management practices, and the Securities Act of 1933 and Securities Exchange Act of 1934 in-

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creased the responsibilities and obligations of company directors and officers. An enterprising insurance broker foresaw a possible new subject for insurance, and, in the mid-1930s, arranged two policies to protect the officers and directors of, on the one hand, a department store chain and, on the other, an investment banking firm. Both policies were placed at Lloyds and covered American clients, although the department store policy included a Canadian subsidiary, and therefore was probably the first D&O policy to cover a Canadian risk.

The basic intention of the new policy was, quite simply, to protect the directors and officers of a company for their individual liability should they be called to account for a breach of duty. An extension was included (either at the inception or within a few years) to cover any sums which the Company might have to pay to reimburse its directors and officers. At some point, concern was expressed as to whether a corporation could legally purchase insurance to protect its directors and officers, and because of this it became the practice to issue two separate policies, one protecting only the directors and officers themselves (who paid the premium), and the other protecting the corporation for its liability to reimburse its directors and officers.

In the last ten years, a number of companies have preferred to issue a single policy covering both liabilities together, but in some cases with clearly separated insuring clauses each with a distinct premium.

The question of whether a corporation has the right to purchase insurance to indemnify its directors and officers has been a source of much debate over the years, and unfortunately the subject remains as murky as ever today. A number of American states have legislation which clearly authorizes its corporations to purchase such insurance, but it is generally held that in the absence of a specific authorization, expenditure of corporate funds for such an end is illegal. However, there have been few legal decisions to clarify the situation. In Canada, section 119 of the Canada Business Corporations Act provides that a Corporation may purchase and maintain insurance for the benefit of officers and directors against liability incurred by them *except* where the liability relates to a failure to act honestly and in good faith with a view to the best interests of the corporation. The Business Corporation Act of Ontario, section 147 (3), provides

that a corporation may purchase and maintain insurance for the benefit of directors and officers, but prohibits such insurance for a contravention of section 144. Since section 144 provides that directors and officers must act honestly and in good faith and in the best interest of the corporation and exercise the degree of care, diligence and skill of a reasonably prudent person, it would seem that very little is left that Ontario corporations can in fact insure. All in all, it would seem advisable for any corporation to charge some portion of the premium to its directors and officers, so that they could reasonably claim to have purchased their own coverage in the event of a dispute. Even then, one wonders whether a judge would accept that 10% of the total premium (which is what is often charged to individual directors and officers) fairly represents the actual cost of the protection. In practice, it seems that many directors and officers policies are purchased by corporations which pay 100% of the premium, without worrying about possible invalidity of the coverage. Insurers no longer routinely indicate separate premiums, and no doubt feel that it is not their responsibility to do so unless specifically requested.

Over the past few years, certain exclusions have been added either because insurers wished to offer specific policies to cover the exposure or because they did not wish to provide the protection under any circumstances. These exclusions are, in the main, the following :

- Punitive damages (Insurers who have this exclusion are unwilling to cover the exposure under any policy) ;
- Pollution (separate coverage may be available for the corporation and its directors and officers) ;
- Claims arising out of payments to domestic or foreign governments or their representatives ;
- Claims arising out of political contributions ;
- Claims based on the U.S. Pension Reform Act of 1974 (ERISA) ;
- The liability to account to the company for benefits received, as defined in the Ontario Securities Act of 1978 or any similar statute elsewhere in Canada.

It can be argued that certain of these exclusions are rather unnecessary. For instance, it is legal, and generally considered acceptable, for Canadian corporations to make political contributions in this country. Why therefore should they be excluded ? As for the exclusion of payments to governments or their representatives, this resulted from a scandal which occurred some years ago when various American companies were found to be paying bribes to foreign officials. Such practices were clearly undesirable but at that time no U.S. legislation existed expressly forbidding such payments. Such legislation now exists, and it would therefore seem unnecessary to specifically exclude foreign bribes, since they would normally come under the dishonesty exclusion. The ERISA exclusion was incorporated as it was felt that the new Pension Reform Act imposed a high level of liability which insurers wished to underwrite under specific policies. The exclusion is incorporated into Canadian policies, either because insurers were worried about U.S. subsidiaries of Canadian companies or because they did not really bother to rethink their wordings for Canadian exposures.

In contrast with these exclusions, some Insurers have recently provided major extensions of cover in the following areas :

- Reimbursement of the defence costs for *penal* charges against directors or officers in connection with their activities as such, provided that they are ultimately found not guilty.
- Reimbursement of the costs incurred by directors or officers when called to testify before a public body of enquiry or for an official investigation.
- Protection for directorships on the boards of outside companies when held at the request of the corporation.
- Professional liability coverage for lawyers and other professionals in respect of duties performed for the corporation.

Some insurers are prepared to cover not only officers but certain other senior employees, and in a few cases all employees. A problem for at least one insurer is that, while an officer is normally responsible for decisions of general policy, other employees may make decisions in the day to day operations of the company causing a loss which is really part of normal business expenses rather than an unforeseen loss which should be insured. For instance, if a clothing manufacturer's D&O policy is endorsed to cover all employees, an

insurer might be called on to pay because a manager ordered a batch of the wrong sort of buttons. In fact, it is not always clear whether an officer is acting in his capacity as officer or otherwise. Many officers, besides making management decisions, will perform day to day tasks which could well be performed by an employee of a lower grade. Could insurers refuse coverage for such an act ? Probably not, if it could be shown that the corporation normally required the officer to perform these lower duties, so that they were in effect a part of his overall functions as an officer. This difficulty points to an inadequacy of the D&O policy – insurers presumably intend to restrict coverage to managerial acts, but rely on a restricted definition of "Insured" rather than trying to define such managerial acts. Clearly, if such a definition were added, all employees could be included without materially increasing the exposure.

The directors and officers policy basically exists to cover individual directors and officers, and, as an extension, to reimburse corporations when they indemnify their directors and officers for their individual liability. There is no protection for claims against the corporations themselves. Why not ? An easy answer is that this is just not the basic purpose of the policy, and that corporations themselves can already be insured by various specific policies elsewhere, in particular the comprehensive general liability form. This is true, but there are still a number of risks which are presently uninsurable, and it is worth examining whether some of these could be covered under a broader form of D&O policy.

As an exercise, it will perhaps be helpful to make a division between firstly the exposure which would normally involve a claim against a director or officer, but where the corporation could also be sued at the same time, and secondly those claims against a corporation which would not normally involve directors or officers individually.

Looking at the first section, the Wyatt 1982 report on D&O insurance lists a number of classes of claimants as well as various categories of allegations. Amongst the claimants, we can probably eliminate stockholders, since they are the owners of the company and therefore it would seem illogical for them to sue the company itself. On the other hand, claimants who could sue both directors and officers, and also the corporation, include : past and present em-

ployees, customers, government bodies, prior owners of acquired companies, contractors and "others" (presumably the public at large). Looking at the list of possible allegations, we can again eleminate those that normally imply a loss to a shareholder, but the following would seem to be a source of possible claims against the corporation itself : collusion or conspiracy to defraud, anti-trust violation, interference with contractual rights, civil rights denial, failure to honour an employment contract, and inadequate supervision. Are not some of the exposures represented by these claimants and potential allegations insurable ? Obviously, there would have to be some exclusions of illegal or dishonest acts as far as the guilty or conniving parties were concerned, but even for these cases it would appear possible for the Company itself as well as its innocent officers and employees to be protected.

Turning to the potential claims against the Company which would not normally involve individual directors and officers, and therefore not areas where D&O underwriters would have any practical experience, what risks could be insured ? Obviously, anything insurable under a general liability policy can be put aside, and this would seem to take care of virtually all bodily injury and property damage situations. Libel and slander can be covered by a specific policy or in some cases be included in the CGL contract. As for pollution, this can be covered by a separate policy. In certain cases, a professional liability policy may exist. However, let us suppose that a corporation decides to open a plant in a certain area, and involves various levels of government in much expense in providing help and guidance as well as installing roads and other services. At the same time, another company builds a hotel in the belief that business will be available. Individuals buy houses in the area expecting a transfer. Finally, the corporation decides that it can make more money elsewhere, and cancels its development plans. The hotel owners, and the local municipality sue the corporation. Possibly this is an insurable exposure, which is not covered at the present time.

When one looks at various liability policies to compare coverages and see where gaps arise, it is difficult to escape the conclusion that all the liability of a corporation should be looked at as a whole, and that ultimately a single policy should be designed to cover all insurable exposures. This would avoid unintentional gaps arising, and be very much more convenient for the insured. Insurers, of course,

love to divide exposures into compartments and then look at each in isolation. This is a legitimate underwriting practice, but it frequently produces an unsatisfactory result for the insured, who naturally tends to see his exposures as forming a whole. Perhaps in ten years time, the directors and officers' policy may no longer exist, but the exposure will be included in a single global corporation legal liability policy.

Terminologie de l'informatique. Office de la langue française, 700 est, boulevard Saint-Cyrille, Québec, G1R 5G7.

Voici un nouveau dictionnaire portant sur la terminologie de l'informatique. Celui-ci a été fait sous la direction de l'Office de la langue française et il se présente comme à l'accoutumée avec le mot anglais d'abord, puis ses équivalents français.

Au premier abord, le dictionnaire nous paraît être fort intéressant et présenter un instrument particulièrement adapté aux besoins du Canada français.

Le livre se divise en trois parties. D'abord un avant-propos, puis le lexique lui-même avec la section anglais/français et un index français, d'une part, et un index anglais de l'autre. La troisième partie est consacrée à la bibliographie.

Nous félicitons l'Office de la langue française pour cette initiative à une époque où l'informatique devient de plus en plus complexe et nécessaire.