



The LFC Shield Guide to Directors & Officers Insurance

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Executive Summary

Cover

Cover is on a claims-made basis and protects the personal liabilities of directors, officers and senior employees from their wrongful acts whilst running the company.

A wrongful act is defined along the lines of a "breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, breach of warranty of authority or other act". Though this may vary between insurers.

It also protects the company when the company can indemnify the director, officer or employee concerned, this is known as Company Reimbursement. Normally this indemnification is only allowed when director, officer or employee is innocent of the allegation and legal defence costs have been incurred in defending them.

Additional cover, sometimes known as "Corporate" or "Entity" cover is also available either as an optional extra or free of charge. This provides cover for your company in a similar way as for your directors etc.

Policies can also be extended to include Employment Practices Liability, protecting you against legal action taken against your company in relation to employment disputes, without the need to take advice from a disjointed "Help" Line, as is usually a requirement of traditional Legal Expenses Insurance.

Some policies are now extended to include cover against the effects of certain crimes.

Who can buy the cover?

- Limited Liability Partnerships
- Public or Private Limited Companies
- Associations and Sports Clubs
- Charities and other Non-Profit entities

The policy is bought by the company or entity to protect and indemnify its Directors and Officers.

Who is covered

The following are covered for wrongful acts:

- directors, be they executive, non-executive, shadow or retired,
- officers (such as Chief Accountants and Company Secretaries),
- supervisory and managerial employees,
- where transferable to a lawful spouse or civil partner,
- employees, where they are jointly named in an action with a Director or Officer.

In addition, all employees including the above are covered for employment related claims (Employment Practices) including discrimination, unfair dismissal, and failure to promote or employ. Some policies have a separate Employment Practices section.

What is covered

- All legal defence costs.
- Damages, judgements and settlements

Policy limits are usually "in annual aggregate" and inclusive of costs.

The Limit of Indemnity you select should be chosen carefully to reflect your exposure. Cover is available from £100,000 upwards

What is not covered (the main exclusions)?

- Illegal personal profit, remuneration or any other proven criminal or fraudulent act, (N.B. The cover does respond to allegations of a criminal nature for defence costs up to the point it is proven.)
- Claims from one insured against another apart from:
 - employment related claims,
 - contribution or indemnity claims ,
 - shareholder claims brought in the name of the company,
 - liquidator claims brought in the name of the company,
 - former directors, officers and senior employees.
- Pollution apart from a sub limit, usually £250,000, for defence costs only
- Bodily injury and property damage although the policy will provide defence costs cover for claims for corporate manslaughter or corporate homicide.
- Any prior or pending litigation.
- Claims made against Directors and Officers by shareholders with 15% (this limit can vary from policy to policy and some will not be subject to the exclusion) or more of shares. In certain circumstances this may be removed in return of the payment of additional premium.
- Whilst acting as a trustee of a pension plan (Separate cover can usually be arranged)
- Nuclear risks.
- Deductible
 - The deductible is normally only applied when there is a US exposure and then only on the Company Reimbursement section.

Where and when can claims arise

- Shareholders.
- Creditors - when wrongful trading has been established.
- Employees – harassment, discrimination, ageism etc.
- Customers and suppliers.
- Competitors - restrictive trade practices
- Regulatory authorities - DTI, Health and Safety executive etc.
- Acquisitions and disposals - misstatements over the value of a company.
- Prospectus exposure - flotations and listings on stock exchanges.
- Management Buy In or Out, share issues etc.
- USA exposure - from assets, subsidiaries or shares traded in the USA or Canada.
- The Enterprise Act 2002 and the activities of the Office of Fair Trading.
- The Health & Safety (Offences) Act which came into force in January 2009.

In addition the new Companies Act 2006 has finally arrived, all 1,300 sections and 760 pages, this is the culmination of an eight-year project.

While it is untested it is the most extensive overhaul since 1948 of the Companies Act and the underlying message is "think small business first".

It encompasses:

- A revised codification of a Director's seven key duties.
- A clear statement that there must be the avoidance of any conflicts of interest.
- A shareholder's right for "derivative" (formerly known as "Class") actions similar to the United States.
- A broadening of corporate responsibility by stating that Directors must promote the success of the Company for the benefit of members and clearly defines "members" as employees, suppliers and customers as well as shareholders and the community.

Examples of real claims are given at the end of this Guide.

Ten reasons why you should have D & O Insurance

- 1) It defends you personally and is based upon the premise that you are innocent until proven guilty.
- 2) Unlike some other forms of insurance, there is no “probability of success” clause as the outcome of any claim may well affect your reputation or livelihood.
- 3) In the event of a claim, it helps to prevent serious disruption to management time.
- 4) It provides protection against potential loss of personal assets including home and possessions.
- 5) It protects corporate assets from the costs of expensive legal proceedings .
- 6) It provides access to lawyers specialising in corporate issues and the framework for a focused strategy for dealing with lawsuits against Directors – especially the frivolous.
- 7) It allows Directors to focus on running the business, which is especially important in times of high risk activities, such as a flotation, MBO or acquisition.
- 8) It can be extended to provide world-wide cover to embrace the activities of international companies.
- 9) It can be extended to include Employment Practices cover as well as cover for claims made against the Company itself, Entity Protection cover.
- 10) If the Company goes into bankruptcy, administration or liquidation the policy continues to the normal expiry date to provide valuable cover at a time when it is most needed.

Seven reasons why you should not have D & O Insurance

As a Director or Officer of your Company you:

1. have a complete grasp of all your responsibilities and duties,
2. never make a mistake,
3. are continually updating yourself of all new developments both within the law or elsewhere that effect your personal liability,
4. have full confidence in all your fellow directors, officers and employees,
5. are absolutely certain that all parties you owe a duty to will never level allegations or file writs against you over actual or alleged mistakes,
6. are certain that your Company will never encounter problems, meet all set targets and continually achieve increasing profits,
7. have a sufficient "fighting fund" available in the event that an action or an investigation is brought against you and your costs and expenses are not recoverable.

Popular misconceptions

The company will pay any damages and legal costs awarded against its directors

By law, the company may only meet defence costs and damages awarded against its directors in certain circumstances. Even then, a director would be unable to insist upon such payments as a right.

I'm not a director so I can't be held liable as an individual

In fact, many senior company officials are viewed as 'directors' in the eyes of the law because their duties are the same regardless of their job title.

We do not have any exposure to D & O because we are a small family-owned company with no external shareholders

The law is fundamentally the same for both private and public companies - and while it is only in exceptional circumstances that directors may be liable to shareholders, they can be on the receiving end of actions from other sources including regulatory bodies and third parties such as creditors, employees and franchisees.

Directors of limited companies have limited liability

It is true that shareholders have limited liability but directors do not, even if they are shareholders as well. In fact, Directors may have unlimited personal liability.

Directors' & Officers' Liability Insurance - Claims examples

The following are all situations where D & O cover may provide valuable protection by meeting legal defence costs and the cost of any awards or settlements made following judgement.

Engineers

Engineering manufacturers entered into a factoring agreement with the claimant, but following the company going into administration, alleged that they used the monies due to the claimant to pay other creditors.

Director Personally Sued £300,000.

Property Owners

Director of a property owning company breached his authority in appointing a company belonging to an employee to undertake work on their behalf.

Proceedings issued by the claimant for non-payment of fees of £42,000 following cancellation of the contract.

Clothing Manufacturer

Directors of a clothing manufacturers facing disqualification proceedings issued by the Secretary of State for trading whilst insolvent, together with allegations that they failed to maintain their accounts in a satisfactory manner to enable the receivers to carry out their duties, leaving many creditors (including HM Customs and Excise) unpaid.

£56,000 paid in defending the directors named in the proceedings.

Cutlery and Giftware Manufacturer

Contractual dispute following appointment of a website developer to design an online trading website for a giftware manufacturer. The director concerned was not authorized to enter into the contract and the company cancelled the agreement.

Website developers claimed against the director for their costs incurred to date of £48,000.

Garage

Claim for legal fees in respect of allegations of wrong classification of employees for PAYE purposes following an investigation by HM Revenue & Customs. Defence

Costs payment £8,500.

Waste Management Company

Transport manager of a waste management company prosecuted by the Crown Prosecution Service following an accident involving an unroadworthy vehicle operated

Claims reserve £15,000.

Glazing Company

Director of a glazing manufacturers named personally in an unfair dismissal claim from a former employee.

Costs incurred of £14,055 in defending the director.

Financial Services

A director of a company was held personally liable to creditors for sums representing the total of payments made to another director as bonuses in the period before the company went into liquidation. It was successfully argued by the company's creditors that these payments shouldn't have been made whilst the company hadn't paid off its preferential debts.

£25,000 paid.

Distribution company

Claim for unfair and constructive dismissal against the Finance Director of a distribution company by a former employee alleging sexual harassment and other inappropriate activity (sending text messages out of working hours, inviting her on nights out etc).

Costs £21,000

Shipping Agents

Shipping agents were required to hold all goods held on behalf of the claimant in a separate account, but following their liquidation, it was discovered that this was not the case, and the claimants would have to recover their goods as a normal creditor.

Directors sued for £61,000.

Makers of timber products

HSE prosecution following serious injuries suffered by a machine operator in clearing a blockage in a stamping machine. There should have been a safety cut out stopping the machine operating with the access panel open, but this had been broken or disconnected.

Defence costs incurred of £25,700.

Manufacturing Company

Action against directors of a manufacturing company by the Health and Safety Executive following their refusal to respond to a notice to control dust emissions. Directors responsible had failed to adhere to deadlines so action taken against both the company and the directors responsible.

Incurred over £110,000 in defence costs, with a further £60,000 outstanding.

Glass Manufacturers

Action taken against the directors of a glass manufacturing company by Trading Standards following allegations of pre-stamping of safety glass before it had passed the necessary testing procedure.

Costs incurred £25,718.

Builders Merchants

Claim for legal fees to defend a criminal proceeding for corporate manslaughter. An employee of company was killed when the brakes failed on his vehicle. It was alleged that the directors of the company cut costs by reducing the frequency of safety and maintenance checks on company vehicles and this led to the brake failure. Costs incurred in respect of representation at inquest by individual director.

Costs incurred in excess of £5,000

Retailer

A company went into receivership and the receiver issued proceedings against former directors alleging various errors and omissions which may have precipitated the insolvency. The directors were alleged to be jointly liable for the shortfall in assets.

In excess of £50,000 paid.

Shipping Company

A company employed claimant for 10 years. A new director came in and Claimant alleged that she received discriminatory treatment from the new director due to her sex and all male employees received preferential treatment. The Claimant went on stress induced sick leave and whilst she was absent, her employment was terminated due to redundancy. The Claimant issued proceedings in an Employment Tribunal alleging unfair dismissal and sexual discrimination.

Costs were in excess of £30k. Settlement sum of £13k.

Some additional themes of claims are: -

- Investigation costs (HSE, Environment Agency, OFT, etc)
- Merger and Acquisition disputes
- Employment disputes - There are many examples where the policy would respond to the costs in defending employment disputes and supporting Insured's through Employment Tribunal hearings.
- Employment disputes after a takeover
- Breach of trading / licensing laws
- Trademark / infringement / copyright disputes
- Libel - adverse comments made by director against competitor

General example 2

The H&SE took action against a group of directors of a building company for gross negligence, manslaughter and other health and safety offences. Those responsible had failed to ensure that risks assessments were carried out, machinery and work processes were safe and proper training and supervision had been provided.

As well as more than £40,000 in fines, the case incurred costs in excess of £140,000.

Warehousing

Upon liquidation of the company it was alleged that the directors mishandled the winding up and distribution of remaining assets. Creditors alleging that the directors' incompetence resulted in the company's inability to pay them.

Costs in excess of £15,000.

Settlement (out of court) £50,000.

General example 1

A director was sued by one of his distributors for a deliberate breach of an exclusive agreement between both parties. It was alleged that the director used commercially sensitive information for personal benefit.

The costs incurred to successfully defend this action exceeded £100,000.

General example 3

Liquidators sued a director of a company that had failed with losses of £1.75m. The director believed the firm to be profitable but the case was still found in the liquidators favour due to his negligence in failing to ensure accurate financial records were kept.

Defence costs unknown.

D & O Insurance is designed to meet the legal defence and settlement costs incurred by individual company directors and other senior personnel as a result of allegations of corporate malpractice. It ensures that they receive expert legal advice and benefit from the support of a professional defence team. In the event that damages and other costs are awarded against them, these too will be met under the terms of the policy.