# Snares and Strategy:
## A Directors & Officers Insurance Primer for Insolvency Professionals

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Once a company becomes insolvent, individuals serving as its directors and officers face new and serious financial vulnerability. Company assets previously available to cover indemnification obligations of directors and officers may no longer exist or at least may be severely restrained. During normal operations, the interests of the company and its directors and officers (D&Os) are closely aligned, but that usually changes upon bankruptcy. Furthermore, D&O insurance policies generally exclude claims brought against their D&Os by the company itself, so after a filing it's every D&O for him/herself.

There are many pitfalls, but also some opportunities for D&Os to protect themselves to some degree against outside claims against them. The insolvency professional involved also has a key role to play. Each situation has to be carefully examined through opinions from insurance and legal advisors, with special attention given to protecting any rights the D&Os may have under a policy. The insolvency professional will also want to guard against potential claims by D&Os for improperly examining, administering and informing them of their rights under a D&O insurance policy.

The first priority, where a new estate has a D&O policy in force, is to refer to legal counsel. Along with that, any known circumstances that may give rise to a claim must be reported to the insurer immediately.

D&O policies are subject to a "claims made" clause, which requires that as the insured first becomes aware of claims, they must report them within the then-current policy period. This differs from most other third-party liability policies, called 'occurrence' coverage, where claims are directed to whichever policy was in force at the time the incident occurred, regardless of when the insured becomes aware of them. The essential risk with a claims-made form, then, is that once there is no longer a policy in force, there is nowhere to report a newly arisen claim.

There are some safeguards. If the insurer cancels or refuses to renew a D&O policy, the coverage contains a Discovery Period Clause stating that the insured has the option to buy an extended discovery period for one or more years. The insured will be required to notify the insurer within a stipulated time period (usually 15 days) after the non- renewal or cancellation if they wish to exercise this option. The premium to activate the extended reporting period is also normally pre-determined, and is often equal to the premium charged for the current policy year. The discovery period covers only against allegations for wrongful acts that occurred prior to the cancellation date but which become known, or are alleged, within the discovery period.

However, if it is the estate, or the D&Os generally, who cancel the policy or allow it to expire, there is no obligation on the insurer to offer an extended discovery period.

D&O policies do not cover against bodily injury or property damage; they are essentially a financial protection against personal liabilities for management decisions. The coverage is

underwritten by Insurers primarily on the strength of the financial statement of the organization. As a result, Insureds that have had D&O insurance in the past may no longer have any cover in force by the time an insolvency professional becomes involved. However, this is often not true of some larger insolvent companies, which one way or another have not only previously persuaded their banks and creditors that they are solvent and viable, but also the D&O insurer who has renewed their policies.

The occurrence of an insolvency, in and of itself, does not constitute a claim, but these matters are often accompanied by allegations of improper acts along with demands from tax authorities holding D&Os responsible for unpaid withholding taxes. D&O policies can be called upon to protect those individuals against a wide variety of allegations — accusations which may be all the more likely during a crisis when conflict, loss and blame are all cresting.

D&Os must act in good faith and in the best interests of the corporation, which means that they account not only to shareholders but to other stakeholders, including employees, creditors and consumers. When trying to satisfy these often disparate interests, D&Os may have to weigh one set of interests against another. These are not easy decisions, and often lead to dissatisfied stakeholders.

Under Canadian law, in making decisions D&Os are not held to a standard of perfection but rather must be able to demonstrate that they acted within a "range of reasonableness" or were "duly diligent" in the exercise of their duties and obligations. Nevertheless, suits are increasingly common.

An example of stakeholder action was the proposed takeover of BCE in 2008, when the debenture holders of Bell Canada tried to stop the deal on the basis that their interests were being compromised, while BCE shareholders were receiving a large premium on their shares. Ultimately, the Supreme Court of Canada approved the potential agreement based on the understanding that in certain circumstances, in satisfying their fiduciary duty to act in the best interests of the corporation, D&Os are sometimes forced to make decisions that benefit one group of stakeholders more than another.

Large claims under D&O policies in the past few years have included Enron, Worldcom, Nortel, Parmalat, Hollinger and Stanford.

Although this article deals with the liabilities of insolvent businesses and their D&Os, it should also impart other far-reaching implications to all readers. Anyone agreeing to serve as a D&O of any company or organization should think carefully beforehand and make sure D&O insurance is in place.

Even joining the board of a non-profit organization has its hazards. Apart from making sure that the organization has its own insurance, in this case D&Os can protect themselves by having a personal umbrella liability policy, making sure that the coverage extends to protect the D&Os of non-profit organizations. This is not the case with all personal umbrella policies so the final message is, as always, to get competent advice from your insurance broker. RS

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