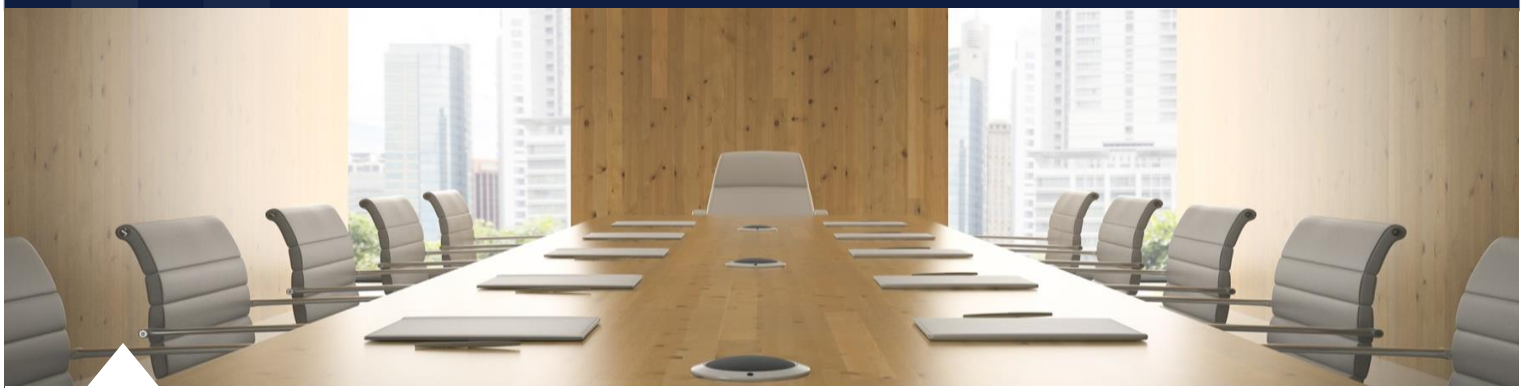

IMPORTANT THINGS TO KNOW ABOUT D&O INSURANCE

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WHAT IS D&O INSURANCE?

Directors' and officers' liability insurance ("**D&O insurance**") provides cover for company directors and officers from claims that might arise from decisions taken when performing their role.

WHAT TYPES OF CLAIMS WILL D&O INSURANCE COVER?

The precise claims that will be covered will always depend upon the wording of the policy. Generally, D&O insurance policies are obtained to cover several risk scenarios, including the following:

- negligent acts by directors and officers;
- employment and industrial relations issues;
- litigation commenced by shareholders;
- reporting errors; and
- unintentional failures to comply with regulations.

Many D&O policies will also provide advance cover for the costs associated with defending claims, such as legal fees.

WHAT WON'T BE COVERED BY D&O INSURANCE?

Generally, D&O insurance will not cover loss that arises from fraud, dishonesty, criminal acts or intentional breaches of legislation or regulations. If only certain directors have engaged in such conduct, but innocent directors are also the subject of a claim, then the innocent directors will usually remain covered by the policy.

PARTICULAR ISSUES RELATING TO D&O INSURANCE

1. POTENTIAL PLAINTIFFS SEEKING ACCESS TO POLICIES BEFORE COMMENCING PROCEEDINGS

Recently, a number of potential plaintiffs have sought court orders allowing them to inspect the D&O insurance policies held by the company they intend to sue. This enables them to assess the commercial viability of commencing proceedings.

For example, if the potential plaintiff's claim is for a significant sum of money and the company doesn't have a policy that will cover the claim, then this is likely to mean the plaintiff won't proceed with the claim.

As a general rule, a court won't compel a defendant to disclose their insurance policy as part of any litigation because the defendant's ability to pay any judgment is irrelevant to the issues in dispute.

However, in recent years, the courts have allowed some potential plaintiffs access to D&O

policies for the purpose of deciding whether to issue proceedings. Almost all of those potential plaintiffs were shareholders of the company who relied on section 247A of the *Corporations Act 2001*, which allows shareholders to apply to the court for an order authorising the inspection of the company books.

Applications for access to D&O policies made under other legislation have been unsuccessful.

D&O policy holders need to be aware of the risk that potential litigants (especially if they are shareholders) may be granted access to the policy in order to determine whether litigation will be worthwhile. If the policy sufficiently covers the potential claim, then the chances of litigation being commenced will increase.

2. PLAINTIFFS PREVENTING POLICY FUNDS FROM BEING USED TO DEFEND PROCEEDINGS

Many D&O policies will provide advance cover for any legal fees necessary to defend a claim. The defence costs available to the insured will usually be limited to the indemnity available under the policy as an aggregate amount.

Plaintiffs have previously attempted to obtain court orders to prevent directors from accessing funds to defend the claim because this will deplete the funds available to meet the claim. This was successful in a New Zealand court but so far, Australian courts have allowed defendants to access the insurance policy to defend the claim.

In considering whether a D&O insurance policy is right for your business, you should consider whether it will also be necessary for the policy to cover the costs of defending proceedings and, if so, businesses should ensure that the terms of the policy are clear when it comes to payment of defence costs because policies that are silent on the issue may be open to attack.

3. ENSURING SHADOW AND DE FACTO DIRECTORS ARE COVERED BY THE POLICY

Sometimes, a person can liable as if they are a director. This can occur when:

- The person has enough influence over a majority of the directors of the company to be able to influence company decisions (a shadow director); or
- The person performs the tasks of a director even though they are not formally appointed (a de facto director).

CLICK HERE TO READ OUR RECENT ARTICLE "WHO IS LIABLE FOR COMPANY DECISIONS?" FOR MORE INFORMATION ON SHADOW AND DE FACTO DIRECTORS

While the wording and inclusions for each policy will vary, it is important for businesses to look at their own structures to determine whether certain key personnel may be de facto or shadow directors and ensure that the definition of who is covered by the policy is broad enough to include them.

FOR MORE INFORMATION, PLEASE CONTACT:

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