



## Directors & Officers Side A and Difference in Conditions Policy

For years, directors and officers were not overly concerned about personal liability arising from their service as directors and/or officers of Canadian firms. Litigation was rare, and they took comfort in the indemnification and insurance provided by the organizations they served.

This is no longer true today.

In today's environment of large bankruptcies, increased litigation and criminal prosecutions, the personal exposure to directors and officers has never been greater. In many of these cases, the availability of indemnification and insurance is far from certain.

### Typical scenarios where indemnification is unavailable:

- **Financial Impairment:** A company which is in financial distress may be financially unable to indemnify its directors and officers
- **Derivative Action:** Claims brought against D&O on behalf of the company in the form of a derivative action are typically precluded by law from being indemnifiable. Examples include stock option backdating and frontloading claims
- **Intentional illegal conduct allegations:** Most Business Corporation Acts prohibit a company from indemnifying, and sometimes even advancing defence costs to directors and officers where the statutory standard of conduct has not been met (i.e., good faith and honesty in the best interests of the corporation, and certain criminal behaviour )

### Typical scenarios where insurance is unavailable:

- **Exhaustion of limits:** The limit of liability provided by traditional D&O insurance is shared across all directors, officers and often the organization itself. Competing interests make the policy more difficult to access and rapidly deplete the aggregate limit.
- **Rescission of coverage:** Insurers have a right to rescind the insurance policy where there has been a material misrepresentation in the application for insurance. A common example is a misrepresentation in a firm's financial statements.
- **Exclusions:** Traditional D&O insurance policies contain exclusions and place obligations on the insured which must be met to trigger coverage. Some examples include: exclusions for claims brought by one insured against another and time requirements to notify the insurer of claims.
- **Operation of law or public policy:** Insurers may not be permitted to provide insurance in certain instances. For example, criminal fines and penalties are uninsurable as typically are intentional harmful acts. Similarly, insurers who are subsidiaries of a US parent may be unable to provide coverage where it is prohibited by U.S. law (e.g. trade sanction restrictions on a company doing business in target countries, such as Cuba).

Side A DIC (Difference in Conditions) policies were designed to cover directors and officers in instances where indemnification and insurance are unavailable. The coverage provides a dedicated limit of liability and the breadth of coverage can be customized from broadly covering all directors and officers to only covering a few individuals (e.g. audit committee).

### Executive Risk Insurance Services:

Recognizing the growing demand for expansive coverage to protect the personal liabilities of directors and officers, Executive Risk Insurance Services (ERIS) has developed a *Directors and Officers Side A and DIC* insurance policy. The policy is designed to provide insurance for claims where indemnity is not available to directors and officers and to drop down as the first dollar to fill gaps in the underlying coverage.



## Overview of Coverage

**Directors or Officers Liability** - Covers loss for which no indemnification has been granted and:

- The underlying insurers have refused or are unable to pay, including a denial of coverage or rescission, or
- Underlying limits have been reduced or exhausted

**Investigation Expenses** - Covers expenses for which no indemnification has been granted arising out of:

- An investigation of the director, officer *or insured company* by a taxing authority
- Notice by a complainant to the directors of intention to commence a derivative action
- An investigation of the director, officer *or insured company* by a securities commission

## Coverage Highlights

### General Terms and Conditions:

- No presumptive indemnification clause (coverage applies if no indemnification available whether rightfully or wrongly denied)
- Claims reporting is as soon as practicable once the Risk Manager or Legal Counsel first becomes aware of the Claim

### Definitions:

- Claim definition extended to include:
  - Informal regulatory and administrative proceedings
  - Extradition requests pursuant to Canadian laws
  - Demands to a director or officer arising out of a tax or securities investigation of a director or officer, *or the company*, or notice of intent to bring a derivative action (with the trigger recognizing unique Canadian laws) against a director or officer
- Director and Officer extended to include trustees, advisory board members, committee members, shadow directors, General Counsel, persons acting in fiduciary capacity of pension program, and employees as co-defendants; includes functional equivalents
- Investigation Expenses does not require a Wrongful Act to trigger policy
- Loss definition provides express coverage for taxes, civil fines or penalties, and punitive or exemplary damages
- Subsidiary definition includes all organizations, including those unique to Canada (e.g., income trusts, unlimited liability corporations)

### Exclusions:

- No pending and prior litigation exclusion
- No insured versus insured exclusion

### Extensions:

- Blanket coverage for Outside Directorship Liability
- Policy is fully severable
- Affirmative coverage for Section 11 or 12 U.S. Securities Act claims ( i.e. will not assert uninsurable loss by reason of disgorgement or restitution)
- Automatic coverage for all Mergers and Acquisitions
- Policy is non-rescindable for any reason

Not all DIC policies are created equal. Particular attention must be paid to the underlying program and what gaps exist that the DIC is expected to fill. For further information on **ERIS –Directors and Officers Side A and DIC Policy**, please contact an **ERIS** representative:

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