In The Wrong

WHAT ARE YOU COMPLAINING ABOUT?

Complaints from shareholders
- Inadequate or inaccurate disclosures
- Divestitures or spin-offs • Takeovers
- Defensive measures

Mergers and acquisitions
- Financial performance and bankruptcy
- Financial reporting • Stock offerings
- Gross management • Investment or loan decisions • Conflicts of interest
- Repurchase or bid to repurchase securities
- Proxy of consent solicitation

Complaints from employees
- Sexual harassment • Invasion of privacy
- Defamation • Age, gender and other types of discrimation • Wrongful dismissal
- Unlawful termination

Complaints from customers and clients
- Extension or refusal of credit
- Debt collection, including foreclosures
- Lender liability • Deceptive trade practices
- Contract disputes • Restraint trade
- Cost, quality of product or services

Competitors
- Antitrust • Copyright and patent infringement
- Deceptive trade practices • Business interference

Government
- Civil rights • Antitrust • Environmental
- Taxes • Safety and precautions
- Securities regulators • Banking regulators

The adage "shun the wrong and do the right" is easier said than done, not just morally speaking but in the area of decision-making as well, so how can company directors keep the lawsuits at bay?

By David Choo

Directors and officers of corporations have to make a wide range of decisions and make them fast. These may involve employees, customers, vendors and regulators. Business leaders sometimes have to decide on mergers, acquisitions and public share offerings, too.

In making all these decisions, every director or officer of either a private or public company faces the risk of committing wrongful acts that could expose them to lawsuits and potential financial loss.

After the Enron scandal, the pressure on directors and officers is even greater given tighter corporate governance and an increasing awareness of shareholders' and consumers' rights, not to mention their increasing propensity to pursue legal action.

Anecdotal evidence shows that this trend is present in Singapore as well. We have seen, for example, a defamation claim made against the current board of a company by a former chief executive, a wrongful dismissal claim by an employee, unfair dismissals, infringement of intellectual property rights, and an ex-director suing an organisation.

But what are the wrongful acts that directors and officers of a corporation may be held liable for? The table **What are you complaining about?** lists the common examples and is by no means exhaustive

The fundamental principle is that directors and officers shall at all times act honestly and use reasonable diligence in the discharge of their duties. These duties can be grouped under three broad categories: fiduciary duties; duties of skill, care and diligence; and statutory duties.

Under fiduciary duties, a director must act in the company's interest, have no conflict of interest and owe a duty to act for the proper purpose. Under duties of skill, care and diligence, a director must show the degree of care and skill that might reasonably be expected from a person of his or her knowledge and experience. Generally, a director must exercise reasonable diligence in performing the duties of his office.

As for his statutory duties, a director must take care of disclosure requirements, and the interests of employees, shareholders and the regulators. Obviously any director or secretary of the corporations or a person employed in an executive capacity by the corporation would be expected to perform those three broad groups of duties properly.

So what protection is there against lawsuits for alleged wrongful acts and against their financial consequences? The policy available is known as Directors and Officers Insurance, or

A Directors & Officers (D&O) policy has many provisions, extensions and optional extras, but let's take a look at the most common concerns.

■ Who pays for the premium? The Company's Act specifically allows a company to purchase D&O insurance for its D&Os.

■ What happens when a lawsuit is taken against a company covered by a D&O policy? The company must respond to the suit. If the D&O are co-named and/or solely named in the suit for a wrongful act, they would be able to seek protection from their D&O policy. The insured should consult their broker immediately who would then notify the insurers.

■ Does the insured have a choice of legal counsel? Some policies require the insured to choose their legal counsel from a panel provided. Others allow the insured to choose subject to the insurer's consent, which shall not be unreasonably withheld.

■ Can the insurer make an offer and insist that the insured accept the settlement if it is accepted by the claimant? What this alludes to is what the industry calls a "Hammer Clause". While the insurer would not be able to insist that the insured accept a settlement with the plaintiff, the Hammer Clause effectively limits the insurer's liability to the amount of settlement. Any claim beyond that would be done by the insured. If the insurer excludes the Hammer Clause the insured may continue to fight the case.

■ What is the experience like of the amount of payout for D&O claims? The amount ranges from several thousand to several million dollars.

■ What are the additional risks that public listed companies face? The risks faced are quite similar to those faced by private companies. Claims could come from regulatory bodies, employees, creditors, shareholders, competitors and the like. The difference is that public listed companies have to contend with public shareholders and possibly more compliance-related issues, such as misstatement or misrepresentation of facts in a prospectus.

■ What are the risks that a private limited firm faces and are covered by a D&O policy? Exactly the same as above. The main difference between public limited and private limited companies is the number and nature of its shareholders.

■ What are the factors that affect the size of the cover? Underwriters look at the market capitalisation of the company, asset size of the firm, the history of the firm, the nature and business activities of the firm, the acquisition history, the financial statements, industry outlook, quality and the expertise of directors and managers, plus corporate governance processes and internal auditing, history of litigations and contingent liabilities. Even this is by no means all-encompassing.

■ Are all the D&O policies basically the same? What about the differences? The basic premise is the same, that is, cover for the directors and officers of a company for a wrongful act committed. Look at the exclusions of the policy, and the definitions of various terms, subjectivities, how defence is conducted, extensions given, the claims quality of the insurer, the security of the insurer etc.

■ What additional risks do independent directors and audit committees face? Are these covered by D&O? These independent directors are often also on the audit committee. Independents are considered to be watchdogs of the company, to provide oversight to the management and the executive directors of the company. So when it is found that they did not appropriately discharge their duties as independent directors, they could face some litigation actions. These are covered by the D&O.

■ What is the trend of D&O claims in US? Are we likely to see similar development here? Recent memory brings to mind the Sarbanes Oxley Act in the US, which amongst other things brings to bear greater scrutiny and accountability of companies' directors, the huge Employment Practice Liability claims, class action suits etc. One D&O survey shows 40% of the outside directors are sued. Local anecdotal evidence shows that shareholders, employees and customers are becoming more aware of their rights and there have been claims made.

■ What is the take-up rate of D&O policies? The take-up rate of D&O is picking up especially among public-listed firms and larger private limited firms. There is greater awareness now even amongst small to medium-sized private companies.

D&O for short. This sort of insurance typically covers all directors (whether they have executive powers or not) and all officers holding management and supervisory functions, and it consists of two parts.

The directors and officers liability coverage basically indemnifies them against all losses that are not paid for by the company, and which they become legally obliged to pay because of their wrongful act. A wrongful act means any error, misstatement, misleading statement, act, omission, neglect or breach of duty, breach of trust or breach of warranty of authority, whether committed, attempted or allegedly committed or attempted.

The second part of the coverage consists of company reimbursement. The policy pays, on behalf of the company, all loss for which it grants indemnification to the insured person permitted or required by law. The insurer also pays for defence costs, settlement and damages. Defence costs are the legal fees for defending any legal action against directors and officers of the company advanced by the insurance company to engage legal counsel.

So to come back to the adage "shun the wrong and do the right", it is time to do the right thing to cover possible and often unintended wrongful acts. Just as ignorance of the law is no excuse, not facing up to risks will not make them go away. **si**

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