



CLAIMS EXAMPLES

A FOCUS ON PRIVATE COMPANY DIRECTORS' AND OFFICERS' CLAIMS

It is widely recognized that directors and officers are operating in an ever-increasing litigious environment. But why do the boards of public companies regularly purchase Directors' and Officers' Liability Insurance while their private company counterparts go without? Directors and officers of privately held companies often underestimate their exposure to potential claimants, personal liability, and the cost of claims, simply because of the trading status of the corporation.

While shareholder exposure can be limited, private companies are still exposed to suits from employees, governments, competitors, and clients. Furthermore, the indemnification provisions of a corporation's by-laws are only as strong as its balance sheet.

Private companies cannot completely avoid exposure to corporate litigation. The board, in making what it believes are all the correct decisions for the corporation, does not guarantee that a management team will not be sued. The defence costs provision of a Directors' and Officers' Liability policy can be a valuable benefit to ensure that a company's assets are available to run the business instead of defending frivolous or groundless claims.

The following claims examples demonstrate the importance of Directors' and Officers' Liability coverage to effective corporate risk management practices.

Alleged Financial Misrepresentation Suit Resulting from Mergers and Acquisitions Activity

A successful British Columbia based manufacturer of trucking equipment sold a subsidiary to a European-based corporation. Within 6 months of gaining control of the subsidiary, the purchaser alleged that the financial statements related to the purchase were incorrect at best and fraudulent at worst. The purchaser launched a claim against the Directors and Officers with alleged damages amounting to more than \$100 million. Defence costs were significant, exceeding more than \$8 million.

Change in Control to Third Generation Leads to Lawsuit at Family Held Corporation

The Directors of a Nova Scotia-based, family owned and operated publishing company, were sued during the transition between the second and third generation of management. Ownership of the company had been split equally among the five children of the initial owner, but voting control of the board was only given to the family members who worked for the firm. As the second generation passed on, ownership was again willed equally to their children. Voting control of the board remained with the three family members who worked at the company, a son and two grandsons of the initial owner. At this point, three members of the third generation, unhappy with the direction of the business and their inability to influence the direction of the business or sell their ownership position, sued their uncle and two cousins in an attempt to force the company to buy back their shares. The lawsuit was eventually settled out of court only after significant legal fees were expended by the company.

Wrongful Dismissal Suit Brought Against Corporation and Officer

A high performing, commissioned sales representative at a Quebec-based medical supply company was fired, with cause, for removing sensitive documents from the company premises without permission, contrary to the employee guidelines. A suit for wrongful dismissal was filed by the sales representative stating that although contrary to stated company policy, the President had verbally approved the document removal as it allowed the representative to work from home on weekends. It was alleged that the real reason for the dismissal was a disagreement over failed attempts to negotiate a new commission structure. Furthermore, subsequent rumours that spread to competitors and clients regarding the reasons for the dismissal had diminished future employment opportunities and caused significant mental and emotional distress.

Oppression Suit Brought Against Private Company Director

A Director and former majority shareholder of an Ontario based food services company was sued by the minority shareholders for oppressive conduct. The claim alleged failure to make complete disclosure of the business and condition of the company prior to the completion of an equity offering: specifically, that the Director and former shareholder no longer held any ownership position or material financial interest. The plaintiffs would not have participated in the offering had they known that the Director no longer had a material financial interest in the company. Relief sought was the return of the monies invested in the offering. Defence costs in the case were significant and were covered by the company's Directors' and Officers' Liability Policy.

Derivative Suit Alleging Breach of Fiduciary Duty and Misappropriation of Corporate Opportunity

A Saskatchewan-based beverage company required financing to fund its operations. An investment corporation agreed to provide \$3.5 million in financing, structured as a convertible debenture that, if fully converted, would account for 80% of the company's equity. In addition, the investment corporation was also entitled to elect 4 of the 5 directors from the time of the funding. After a number of years, the investment corporation elected to trigger the conversion option thereby owning 80% of the equity. One month post conversion, two of the investment corporation's appointed directors resigned and, five days subsequent to their resignation, they made an offer to purchase 80% of the beverage company from the investment corporation. The deal was approved by the investment corporation and the board of the beverage company. Shortly thereafter, another shareholder of the beverage company brought forward a derivative action alleging that the board of the beverage company failed in its duty to negotiate the sale in the best interests of all shareholders, and that the two individual directors breached their fiduciary duties, using confidential insider information for personal gain.

Alleged Misrepresentation Leads to Suit

Looking for new ways to market their product, an Alberta-based manufacturing company agreed to become a sponsor of a high profile racing team. Due to financial difficulty experienced by the manufacturing company, the contract was breached prior to the start of the racing season. The team, unable to secure alternative sponsorship, was forced to race the first 5 events of the season without a major sponsor. They subsequently sued both the manufacturing company and the CEO for financial misrepresentation and lost business opportunity. While the Directors' and Officers' Liability policy will not cover amounts owing from a breached contract, it will defend the allegations of misrepresentation leading to the breach.

Financial Impairment Leads to Director Liability

An Ontario-based flooring manufacturer, unable to adjust quickly enough to changing market conditions, was forced into bankruptcy. Suits were filed against the former Directors of the company by both the Ministry of Finance and the Canada Revenue Agency in an attempt to collect unpaid PST and GST totaling more than \$1.5 million. In addition, employees of a Quebec-based subsidiary company commenced an action seeking \$750,000 in unpaid wages, pay in lieu of notice and vacation pay. The Directors' and Officers' Liability policy paid \$1 million towards this claim. The remainder of the loss was uninsured as the limit of liability was exhausted.

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