D&O RISK & LIABILITY

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CANADA

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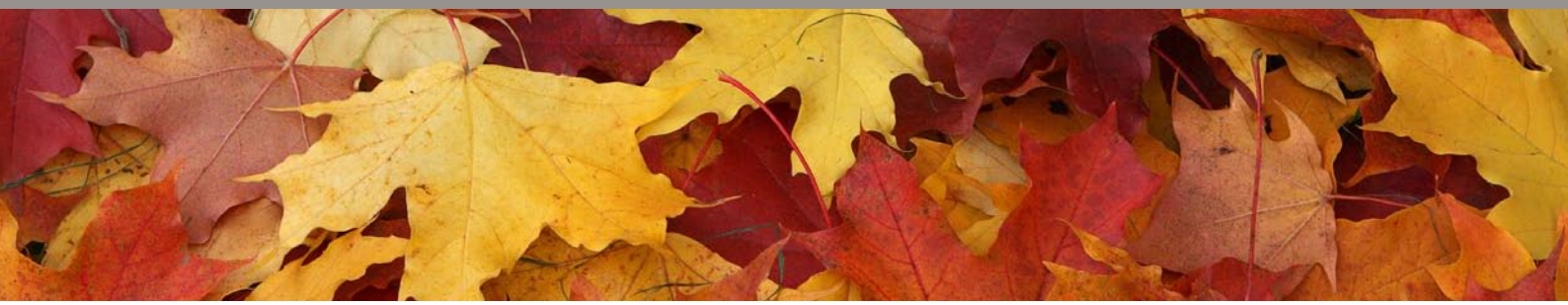
Q IN WHAT WAYS ARE THE PRESSURES EXERTED BY REGULATORS, CREDITORS, CUSTOMERS AND SUPPLIERS INCREASING THE PERSONAL RISKS FOR CORPORATE DIRECTORS AND OFFICERS (D&OS) IN CANADA?

SMITH: The most recent pressures exerted on D&Os in Canada have come from several, multiple points of attack. Securities regulators, particularly in Ontario, have become especially aggressive in their investigations of companies and their executives. Ontario now has a whistleblower programme which provides an added incentive to come forward and report the wrongful conduct of D&Os, even paying monetary awards to whistleblowers who provide useful information. A second development in this area has been the advent of litigation funding following the recognition by Ontario courts of the ethics of allowing plaintiffs to obtain so-called 'access to justice'. It is interesting to note that, in introducing secondary market liability in Canada, the view was that litigation arising out of the change in the legislation would not bring American-style securities claims to Canada. With the advent of litigation funding, however, where the plaintiffs no longer have to pay the costs now covered by the litigation funders, there has been an objective increase in securities litigation in Ontario. Lastly, environmental liability presents great risks for D&Os, as they can be exposed to the liabilities of an insolvent company. Many D&O policies do not cover environmental liability due to its prohibitive costs. All D&Os should ensure that environmental liability is part of their D&O coverage. As an aside, all D&Os should consider having an extended reporting period and run-off provisions if the company has any environmental risks whatsoever.



Q WHAT TYPES OF CLAIMS ARE BEING BROUGHT AGAINST D&OS IN CANADA, INCLUDING ISSUES ARISING FROM BUSINESS DECISIONS, FINANCIAL PERFORMANCE AND BANKRUPTCY, THROUGH TO ALLEGED FRAUD AND CORRUPTION?

SMITH: The types of claims made against D&Os fall into four major categories: company lawsuits, director or shareholder suits, security suits and regulatory enforcement actions. As a subset, the so-called 'business judgment rule' does not necessarily apply to the duty of disclosure. However, issuers, directors and officers may rely on certain defences which remove liability where there was a reasonable basis for making a particular forecast or drawing a conclusion and the prospectus contains reasonably cautionary language and a statement of the assumptions underpinning the forecasts and conclusions. Where a misrepresentation in a prospectus is made out, the liable parties will be held to be jointly and severally liable. Secondary market purchasers may also bring a statutory cause of action against an insured, including D&Os, for misrepresentation in specified documents and public oral statements released by or on behalf of the issuer and, just as importantly, for the failure to disclose material changes since the issuance of the prospectus.

Q GIVEN THAT VIRTUALLY EVERY M&A TRANSACTION NOW SEEMS TO DRAW SOME FORM OF LITIGATION – PERHAPS RELATING TO DISCLOSURES, CONFLICTS OF INTEREST, ERRORS AND OMISSIONS, OR ANOTHER ISSUE – WHAT IS YOUR ADVICE TO D&OS ON MANAGING POTENTIAL LIABILITIES ARISING FROM A DEAL?

SMITH: I would highlight two areas of potential exposure for the D&O. First, ensure that the company carries out preliminary and subsequent proper due diligence. Second, in carrying out due diligence, the D&O must be scrupulous in preparing and signing NDAs and remain absolutely in control of its disclosures. There are more class actions being issued in Ontario than was previously the case as the judges have moved to a more aggressive stance on allowing access to justice. This will inevitably mean that more D&Os will be involved in litigation in the future.

Q TO WHAT EXTENT IS THE LITIGATION LANDSCAPE CHANGING? FOR EXAMPLE, ARE YOU SEEING MORE SECURITIES CLASS ACTION LAWSUITS AGAINST D&OS IN CANADA?

SMITH: Historically, most D&O claims were a result of statutory liability and the insolvency of the corporation, usually with respect to unpaid wages, taxes and pension plan contributions. When a company becomes insolvent, the D&O policy may become the only tangible source of recovery for shareholders. This has given rise, more recently, to liability for breach of corporate governance legislation, derivative claims and claims under oppression remedy legislation. Lastly, and particularly with insolvent companies, Ministry of the Environment clean-up orders can be imposed directly on both current and, in some cases, former board members.

Q HOW WOULD YOU DESCRIBE THE DEFENCE COSTS ASSOCIATED WITH DEFENDING CLAIMS AGAINST D&OS? ARE THESE COSTS ON THE RISE?

SMITH: As class action firms, and plaintiffs law firms generally, find new sources of funding for litigation, they continue to be more aggressive, including in the extensive use of expert evidence. Defence costs continue to rise and, as new causes of action are conjured up, defence counsel must vigorously defend them. Fortunately, most sophisticated D&O policies allow D&Os to choose their own counsel and not be constrained by the insurers' normal counsel panel. In such cases, seldom are hourly rates or accounts challenged by insurers. Of course, for Canadian D&Os, were it not for insurance, the cost of defending themselves in any litigation would be onerous.

Q IN YOUR OPINION, HOW IMPORTANT IS D&O LIABILITY INSURANCE AS A TOOL TO MITIGATE THE PERSONAL RISKS TO BOARD MEMBERS? DO YOU BELIEVE ENOUGH ATTENTION IS PAID TO THIS ISSUE IN CANADA?

SMITH: D&O liability insurance is absolutely necessary and, without underscoring the issue, one would be foolhardy to take a board position without a D&O policy with a specialised D&O carrier after having had the D&O policy reviewed by counsel. It is becoming more commonplace for coverage counsel to review D&O policies before they are accepted by the D&O.

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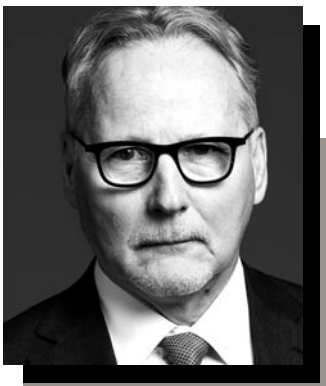
Q WHAT IS YOUR ADVICE TO COMPANIES AND THEIR D&OS WHEN ASSESSING THE TERMS, COVERAGE AND PRICING OF A D&OS INSURANCE POLICY?

SMITH: Of course, with the help of D&O coverage counsel, companies should obtain an experienced broker in D&O insurance. An international broker will be far more adept at understanding the intricacies of a D&O policy, particularly when D&O claims can be global these days. A good broker and lawyer are worth their weight in gold. While defence costs rise slightly every year, D&O insurers allow the D&O to choose his or her own counsel and they do not hold them to the standard, unrealistic rates that they may hold their own panel counsel to. Therefore, if the policy is well-chosen, apart from the indemnity should the D&O lose, the costs should not be a major factor if the D&O has chosen well.



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Glenn Smith is one of the five founding partners at Lenczner Slaght. He has a diverse commercial litigation practice with an emphasis on product liability and complex insurance litigation. He also has expertise in the legal dimensions of technology. He appears regularly before a wide variety of courts and tribunals, including the Supreme Court of Canada, acting both for and against public and private companies, financial institutions and governments. Mr Smith has frequently lectured and written on D&Os liability, class actions, e-discovery, cross-border litigation and insurance law. He is also a certified mediator.

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