IBA Insurance Committee Substantive Project 2009

D & O Cover: Joining the dots...

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About the International Bar Association Insurance Committee

Insurance is present in every facet of commercial, industrial and private life. Lawyers practising in many different fields encounter insurance and its problems and can greatly benefit from the knowledge which membership of this committee provides.

The Insurance Committee aims to provide its nearly 600 members, and the IBA Legal Practice Division as a whole, with information about developments in insurance and reinsurance law and markets throughout the world as well as with specialist knowledge to assist in the efficient solution of practical insurance problems. New insurance products are also brought to the attention of members.

In addition to this publication, the committee produces a newsletter for its members which provides updates and commentary on developments and issues in the field.

The committee also presents sessions at the IBA Annual Conference every year. In 2010, the conference will be held in Vancouver. Please see http://www.ibanet.org for more information on this and other upcoming events.

If you would like to join the Insurance Committee, or if you would like further information on the committee's activities, please visit http://www.ibanet.org.

We also invite you to contact the IBA membership department on

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or by email at member@int-bar.org.

Note from the IBA Insurance Committee

Following the excellent response to our 2008 substantive project, which dealt with the impact of local law on claims made policies, this year we decided to undertake a much more challenging endeavour.

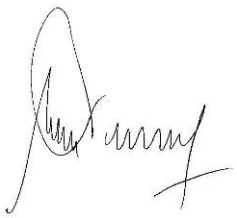
We decided to conduct a comparative analysis of the risks to which corporate representatives are exposed in this rapidly changing globalized market and the insurance and indemnification solutions available to cope with those risks.

With contributions from our members from 21 jurisdictions, this publication is the result of a very practical analysis of the various challenges faced by corporate representatives around the world in this time of profound interrelation among large and sophisticated companies with operations in multiple countries.

This comparative analysis was made by a number of specialized insurance professionals as the current global crisis was unfolding, which makes it even more appealing to anyone who is faced with managerial and executive functions, regardless of their link to the insurance industry.

We would like to thank those of you who generously contributed your time and expertise to successfully complete this project.

Best regards,



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Editorial

D&O COVER: JOINING THE DOTS

A Comparative Analysis of the Form and Nature of Liabilities to which Corporate Representatives are Exposed and the Insurance and Indemnification Products Available to Cover such Liabilities

In a time of financial meltdown, those persons who represent large corporations, particularly quoted companies, find themselves in the spotlight of claims activity, as those who have lost money as a result of the corporation's activities (or inactivity) seek scapegoats and deep pockets from which to recoup their losses.

Global corporations place heavy responsibilities on their senior employees to become directors and officers of subsidiary entities in far-flung and often poorly-understood jurisdictions.

Understanding the varying forms of responsibility that impinge on directors and officers of corporations is a subject fit for careful study in every jurisdiction in which a person is implicated by virtue of their formal appointment. Codes, Ordinances, Lois, and common law sources jostle with each other to spread a wide and uneven net in which the unsuspecting director may become entrapped.

The issue of insurance coverage available to protect such persons (and their corporations) from the consequences of human error - or worse - is a topic that rarely attracts much study, save among the true specialists of the international insurance world.

"D&O" or "Directors' and Officers'" liability coverage is moreover one of the least well understood and, in many jurisdictions, under-developed, forms of insurance coverage.

The IBA Insurance Committee therefore determined to conduct a survey, the results of which are now published in this document, in the form of a composite report including all suitable contributions.

The survey was initiated in the form of a questionnaire prepared by the editors (the template of which is annexed to the document) and distributed to members of the Committee and close associates in the early part of 2009.

Responses to the survey were of universally high quality.

The report explores issues such as; who are considered to be D&O; what are their duties, and to whom are they owed; what cover is available, and how does it work in practice.

Comparison of the results shows that duties are owed far and wide: to shareholders, creditors, employees, regulators, liquidators, insurers, governments, stock and insurance exchanges, social security, and the inevitable tax-man.

Standards range from normative duties of care akin to those of the ordinary private citizen to highly specific obligations unknown to other jurisdictions, and comprehensible only by virtue of a knowledge of the juridical, political and constitutional peculiarities of the state of incorporation.

On the insurance front, the dominance of parent company influence and the coverage expectations of overseas global insurers was a constant theme, offering much scope for mismatch between the standards of care on the ground and the conceptual and foreign-inspired events and types of coverage available.

As the consequences of the excesses of the financial markets play through into a distribution of responsibility into the worldwide markets, and as globalization of corporate structures increases, this publication offers a sobering but informative insight into an area of increasing relevance to the modern international director.

The editors would like to thank the contributors for their time, expertise, insights and efforts, which are here displayed to the full.

Particular thanks are due to Natasha Gunney, of Lovells, LLP, London, upon whom much of the administrative and technical burden was placed in the course of the survey, and borne with good humour, efficiency and stoicism in equal measure.

Peter L Taylor

Argentina

MARTIN D MANZANO AND ELIAS F BESTANI, MARVAL, O'FARELL & MAIRAL

Form and Nature of Liabilities to which Corporate Representatives are Exposed

1. Who are considered to be responsible directors and officers?

Under the Argentine Companies Act, the directors are in charge of the administration of a company and are appointed by the shareholders at a shareholders' meeting. The term refers to executive and non-executive directors and there is no such thing as a "shadow director".

The definition of officer will depend on the wording of each D&O policy. In general, an officer may be referred to as a manager (gerente) upon whom the board of directors of a company delegated executive functions. These managers may or may not be appointed to the board of directors.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The general duties are, basically, the duty of loyalty towards the company and its shareholders, and the duty of care (article 59 of the Companies Act).

The standard for the duty of loyalty is that of the "honest person". This standard requires a director to act with the correctness of an "honest person" and to promote the interest of the company. Directors and officers must refrain from competing with the company in the furtherance of their own interest or that of a third party.

The duty of care is measured by the "good businessman" standard, which may be briefly described as the reasonable care, qualifications, skills and diligence required from a director in light of the particular circumstances of each activity undertaken by the director.

Under article 274 of the Companies Act, specifically referred to stock corporations, directors may be joint and severally, and unlimitedly, liable vis-à-vis the corporation, the shareholders and third parties, for the improper discharge of their office (as per the standards of article 59), as well as in case of violation of the law, the bylaws or regulations of the corporation, and for any other damage caused by fraud, abuse of power or gross negligence.

The rules applicable to directors apply also to managers (gerentes) of a corporation. The liability of officers who are neither directors nor managers of a corporation, is governed by the general rules of agency and tort as well as by the Employment Contract Law. Therefore, they may be held liable for the improper discharge of their duties resulting in damages to the corporation or third parties by reason of their wilful misconduct or negligence.

Liability towards the company and its shareholders may be waived by the approval of the performance of the directors or by an express waiver resolved by the shareholders' meeting, provided such liability had not arisen for the violation of the law, the bylaws or regulations of the company, and provided further that shareholders representing at least 5% of the capital stock do not oppose.

In addition, a director may be exempted from liability under two circumstances. First, if the bylaws or a shareholders' meeting specifically allocated the functions of each director and such allocation was registered in the Public Registry of Commerce, the attribution of liability will be made according to such allocation. Also a director who participates in a given decision, or knows about it, is released from liability if he or she leaves written record of his or her protest and advised the statutory auditor before his or her liability is reported to the board of directors, the statutory auditor, the shareholders' meeting or the Government authorities, or before a lawsuit is brought in that regard.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Please refer to our answer in paragraph 2 above.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As mentioned in paragraph 2 above, directors and officers (particularly those officers that serve as managers of the company) may be joint and severally liable towards third parties for the improper discharge of their office (as per the standards of article 59), as well as in case of violation of the law, the bylaws or regulations of the corporation, and for any other damage caused by fraud, abuse of power or gross negligence.

While directors and officers may be exempted by the company and its shareholders for an improper discharge of their office with respect to the company and those shareholders, liability towards third parties arising from a violation of the law, the bylaws or regulations of the corporation or from damages caused by fraud, abuse of power or gross negligence may only be waived by the affected third party.

In these cases, liability must be established on a personal or individual basis.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under article 300(3) of the Criminal Code, a director or officer (deemed a manager) of a company may be criminally liable, and subject to imprisonment from six months to two years, for the wilful misrepresentation of the financial statements of the company.

In addition, under certain circumstances a director may be liable for tax and customs liabilities of the company. In general, this liability may arise if it was established that the director: (i) was in charge of the disposition of the funds of the company, (ii) had in fact sufficient corporate funds to pay the debt, (iii) wilfully or negligently breached his duties to pay taxes, and (iv) that the debtors (company and incumbent director) were previously formally demanded to regularize their tax dues.

Directors and officers may be also subject to fines and other administrative sanctions for their personal breach of securities exchange, antitrust, anti-money laundering, and environmental legislation.

Likewise, directors and officers of financial institutions and insurance companies may be held personally liable towards the company, the shareholders, third parties and their regulators.

This type of liability towards the State may not be exempted.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Argentine courts are increasingly holding directors and officers joint and severally liable together with the company for unregistered employment on the basis of fraud, violation of the law or public policy principles. Directors and officers may not be exempted by the company or its shareholders for their liability towards unregistered employees.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under Argentine law, directors and officers may only be held liable for the debts of the company if it were established that they wilfully produced, facilitated, allowed or worsened the financial condition or insolvency of the company.

As mentioned in paragraph 2 above, the approval of the performance of the directors by the shareholders' meeting or an express waiver resolved by the shareholders' meeting will not be effective in the event the corporation is subsequently liquidated by operation of law or under a bankruptcy process.

8. What remedies are available?

In general, both the award of damages or fines may be imposed, depending on the type of liability involved.

9. Who has the right to claim?

Directors and officers may be sued by the shareholders of the company, third parties (including, among others, creditors, trustees in bankruptcy, and employees), governmental authorities and the company itself.

There are two types of corporate actions against directors: (i) a corporate action brought by the corporation itself; and (ii) a derivative action filed by a shareholder or group of shareholders. Both these actions seek an award for damages in favour of the corporation. A derivative corporate action may not be brought unless the shareholders have debated and resolved the issue of liability of the directors.

Also individual private actions are available to shareholders and any other third party. This action is particularly useful to protect minority shareholders directly and adversely affected by a decision of the directors or a ratification of such decision by the shareholders' meeting

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Directors and officers liability insurance is valid under Argentine law. Article 113 of the Argentine Insurance Law specifically provides that liability for carrying out a trade or industry includes the liability of the persons with direction functions. Also the National Superintendence of Insurance has approved D&O policies to be marketed in Argentina.

D&O insurance may be purchased by the company or by the directors and officers themselves (although it is generally purchased by the company).

11. Are there any corporate procedural prerequisites to effecting cover?

The purchase of D&O insurance will require a prior resolution from the board of directors

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

As with any resolution, directors must adopt the decision to purchase D&O insurance with sufficient information to be satisfied that they are acting in the company's interests.

As regards the disclosures to be given to insurers, this will very much depend on the proposal form requested by the insurer prior to entering into the insurance contract. Insurance contracts in Argentina are contracts of utmost good faith. Therefore, any false statement or misrepresentation of circumstances known to the prospective assured that, had the insurer be aware of, would have impeded the contract or modified its terms, would render the insurance contract null and void.

13. Are there any tax implications connected to the purchase of D&O cover?

The purchase of D&O insurance is subject to the Value Added Tax (VAT).

14. Is insurance of D&O exposures compulsory in respect of any type of company?

Under the Companies Act, the bylaws of a corporation must establish the guarantee that will be required from their directors in order to serve in the board of directors (article 256 of the Companies Act). According to the regulations in force in the city of Buenos Aires, this guarantee must be for a minimum amount of AR$10,000 (equivalent to approximately US$2,600) and D&O cover is one of the means available to comply with this requirement.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

Insurance contracts in Argentina must be purchased from Argentine-licensed insurers. Of course that it is usually common to obtain reinsurance abroad.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The main the beneficiaries of the insurance will be the individual directors and officers. The company may also obtain reimbursement cover in respect of any monies which may be bound or entitled to pay by way of indemnity to its directors and officers

17. What is commonly covered?

D&O insurance in Argentina provides indemnity for liabilities incurred by directors and officers in their performance of their functions for a given company. The sum insured usually covers, in addition to judgment or settlement amounts, judicial and extrajudicial legal costs incurred in civil claims and may be extended to cover legal costs incurred in the criminal defence of the assured.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Unless otherwise provided, fines are excluded. Under Argentine law, liability insurance may not cover fraud, and it is generally understood that gross negligence may only be covered by an express provision of the insurer.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

In principle the relevant directors and officers. The company may also bring a claim under the policy if it has indemnified the directors and officers pursuant an indemnity agreement. Also affected third parties may bring the insurer to the lawsuit against the assured.

20. What is the procedure for bringing a claim?

The contract will typically establish a maximum term for the assured to give notice of a claim or circumstance that may give rise to a claim under the policy. Late notice may entitle the insurer to reject the claim. In the context of civil litigation against the directors or officers, third parties and the assured may bring the insurer to the proceedings before entering the evidence stage (citación en garantía).

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

It is generally accepted that the company may indemnify its directors and officers for the liabilities they may incur in the performance of their office. The company may not, however, agree in advance to indemnify its directors and officers for their wilful misconduct.

22. How is the indemnification dealt with in practice?

Directors and officers commonly require a formal indemnity undertaking from the company or the foreign controlling shareholder.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

The Public Offerings Transparency Regime (decree 677/2001, as implemented by the National Securities Commission), provides certain corporate governance regulations to which companies listed in Argentine stock exchange markets must adhere. Under this regime, listed companies may purchase D&O cover for their directors and officers provided their bylaws do not prohibit it.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

There are no material changes anticipated in the near future.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

There are no anticipated changes in the near future.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

As we mentioned in paragraph 6 above, there is a growing tendency in our courts to extend the liability of the company for unregistered employment to directors and officer. These cases are not covered under D&O policies.

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Australia 1

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This publication is only a general outline. It is not a legal advice. You should seek professional advice before taking any action based on its contents.

1. Who are considered to be responsible Directors and Officers?

A director[2] is a person who is:

- appointed as a director or alternate director and who acts in that capacity regardless of the name given to their position - this will include executive directors; or
- not validly appointed as a director but who:
  - acts as a director; or
  - is a person in accordance with whose instructions or wishes the directors of the company are accustomed to act (excepting merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the company). This includes shadow directors.

Officer[3] of a corporation means:

- a director or secretary of the corporation; or
- a person:
  - who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
  - who has the capacity to affect significantly the corporation's financial standing; or
  - in accordance with whose instructions or wishes, the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or
- a receiver, administrator or a liquidator.

2. What are the duties/liabilities of Directors and Officers to the company?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

A director of a company under general law owes various duties to the company. Duties are also imposed on a director under the *Corporations Act*. In brief, in general terms the duties of a director are:

(1) duty of care: the director is obliged to exercise due care, skill and diligence in acting as a director of the company;

(2) duty to act loyally: the director is obliged to act in good faith, exercise his or her powers for proper corporate purposes, act honestly and avoid conflicts of interest.

The *Corporations Act* also imposes more specific formulations of duty, for example:

- not to use position or information improperly to gain personal advantage or cause detriment to the corporation (s 182 and s 183); and
- to disclose to other directors any material personal interest in a matter that relates to the affairs of the company, including interests in contracts or proposed contracts, and the holding of any office or property (ss 191(1)). (Refer also Q 8(a) below).

3. What are the duties/liabilities of Directors and Officers to the shareholders?

(a) at Common Law;

(b under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

Directors' powers are fiduciary in nature and they have to be exercised in the interests of the company. Directors, accordingly, owe their duties to the company. Additionally, in some circumstances, a director can owe duties to individual shareholders or other stakeholders. In January 2007, the High Court decided in *Sons of Gwalia v Margaretic* [2007] HCA 1 that a shareholder, if misled, can be treated as a creditor and their claim, if proved, can rank equally with other creditors.

4. What are the duties/liabilities of Directors and Officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

Directors have a duty to take into account the interests of creditors when the company is insolvent or approaching insolvency but this is only part of a director's broader duty to act in good faith in the best interests of the company. It is unlikely that directors owe an independent duty to creditors under the common law. Rather, where a company is insolvent or nearing insolvency, the creditors have a direct interest in the company which must be taken into account by directors. Whilst certain actions which may give rise to a question mark as to whether it is in the interests of the company may be able to be ratified by shareholders, actions which occasion prejudice to the company's creditors, imperilling the company's ability to meet its financial commitments or jeopardising its solvency, cannot be authorised by resolution of the shareholders.

In some Australian states and territories, the occupational heath and safety ("**OH&S**") legislation imposes liability on

directors in relation to the death or serious injury of a person in the workplace where this results from a breach of OH&S legislation. The extent of liability varies somewhat between the jurisdictions. However, severe penalties, including gaol terms in some instances, are available where directors are found guilty of OH&S offences.

5. Who has the right to claim?

The company has the primary right to enforce a breach of duty. Additionally, a company's shareholders and other persons might have a right to initiate proceedings against a director for a breach of duty. Accordingly, proceedings may be initiated against directors by the company, liquidators or administrators of the company, in some circumstances by shareholders on behalf of the company, by creditors or by the corporate regulator, the Australian Securities and Investments Commission ("**ASIC**").

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

6. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

A company may purchase D&O insurance but it is necessary to ensure the company has power to make the payment. However, a company is prohibited (s 199B) from paying or agreeing to pay the premium for insurance of an officer or auditor against a liability (other than for legal costs) arising out of:

- conduct involving a wilful breach of duty in relation to the company; or
- a contravention of s 182 or s 183 (improper use of position or information prohibition).

Anything that purports to indemnify or insure an officer or auditor against a liability in contravention of s 199A and s 199B (or either) is void and the company commits an offence (s 199C). (See Q 16 for a description of s 199A.)

There is some debate as to whether a 'wilful misconduct' exclusion in a D&O policy excludes all conduct within the nexus of s 199B. A tailored s 199B exclusion is now commonly included in standard D&O policy wordings. This eliminates the risk that a wilful misconduct exclusion may not include in its ambit all conduct within the nexus of s 199B.

Another approach sometimes adopted where a policy does not contain a tailored s 199B exclusion is for the premium to be apportioned between side B company reimbursement cover (typically 99% and paid by the company) and side A direct cover (typically 1% and paid by the insured directors and officers). This approach is based on the argument that the side A direct cover and side B company reimbursement cover represent two separate contracts of insurance - one contract between the insurer and directors and officers of the company and the other between the insurer and the insured company. Whether or not this approach successfully complies with s 199B has not been tested and is the subject of ongoing debate. The argument is that if the premium apportioned to the side A direct cover insurance contract is paid by the insured directors and officers or any one or more of them, s 199B does not apply - for the reason the company has not paid the premium for the cover. One concern with this line of argument is that 1% of the premium is unlikely to correspond to the risks insured by side A. A court may therefore conclude that in substance company resources are nevertheless being applied towards the purchase of insurance cover proscribed by s 199B.

In connection with certain reforms made to the *Trade Practices Act 1974 (Cth)* since 1 January 2007, a question has arisen whether a company can pay the insurance premium for an insurance policy which insures officers in respect of civil penalties imposed in connection with contraventions of Part IV (the restrictive trade practices division) of that Act. Analogous considerations also arise in connection with certain reforms presently proposed to be made to:

- the *Trade Practices Act* - in respect of insurance of officers against civil penalties imposed for contraventions of other civil liability provisions of the Trade Practices Act; and
- the *Australian Securities and Investments Commission Act 2001 (Cth)* ("***ASIC Act***") - in respect of insurance of officers against civil penalties imposed for contraventions of provisions of the ASIC Act dealing with unconscionable conduct, consumer protection and substantiation notices.

These issues are discussed below in Q 16 and Q 19.

7. Are there any corporate procedural prerequisites to effecting cover?

Where a public company (or an entity it controls) gives a financial benefit to a "related party"[4], such as paying (or agreeing to pay) an insurance premium for a director or officer classified as a related party, the company must first obtain shareholder approval in compliance with the notification and approval procedure in Part 2E.1 - except where giving the benefit comes within an available exemption from that regime. For example, in relation to an insurance premium payable (or agreed to be paid) for insurance in respect of liabilities incurred as an officer or auditor of the public company (or controlled entity), under ss 212(1) shareholder approval is not required if giving the benefit would be reasonable in the circumstances of the public company or entity[5]. The test for establishing whether a benefit is reasonable is set out in ss 212(3).

8. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

(a) Directors and officers have a material personal interest in insurance effected by a company which insures them against liabilities incurred as directors and officers of the company. As noted in Q 2 above, directors generally have a duty[6] to

disclose any material personal interest in a matter that relates to the affairs of the company. This includes interests in contracts or proposed contracts. This general duty of disclosure is, however, subject to certain listed exceptions[7]. The exceptions include an interest that relates to an insurance contract which insures the director against liabilities that the director incurs as an officer (provided the company or a related company is not the insurer).

As noted in Q 7, prior shareholder approval will be required for public companies where payment of the insurance premium (or an agreement to do so), does not come within an available exemption under the "related parties and financial benefits" regime[8] of the *Corporations Act*. Obtaining shareholder approval is prudent even if it is not always legally necessary.

(b) Subject to certain listed exceptions, before entering into an insurance contract, an insured is required to disclose to the insurer all matters known by the insured, that the insured knows or that a reasonable person in the circumstances of the insured could be expected to know, are relevant to the decision of the insurer whether to issue a policy and, if so, on what terms[9].

The duty of disclosure also operates when an insurance contract is renewed (or extended or varied). A failure to comply with this duty may entitle the insurer to deny or reduce its liability for subsequent claims or, if the failure was fraudulent, to avoid the insurance contract altogether[10].

The obligation to disclose rests on the contracting party/parties to the insurance contract, although an insurance proposal may require a contracting party to make enquiries of other persons - for example additional proposed insureds outside the contractual nexus - and disclose the outcome of those enquiries. If an individual director is party to the insurance contract they owe a duty of disclosure to the insurer.

9. Is insurance of D&O exposures compulsory in respect of any type of company?

No.

10. Is D&O insurance usually purchased locally or purchased from overseas markets?

Commonly primary layer insurance is placed locally, with excess layers being placed overseas.

THE EXTENT OF COVER

11. Who are the beneficiaries of the insurance?

The beneficiaries of the insurance will depend upon the terms of the policy but will usually include a company and its subsidiaries and their directors and officers (in that capacity). Additionally, committee members, directors of superannuation fund corporate trustees, and senior employees may be covered (in such capacity). Officers such as receivers, administrators and liquidators are usually excluded.

Where a person to whom the insurance contract extends protection is not a party to the insurance contract they have a statutory right to enforce the contract directly against the insurer[11]

12. What is commonly covered?

D&O policies may provide three types of cover (Side A cover, Side B cover and sometimes Side C cover, although premiums for Side C cover are increasing).

Side A cover - provides cover (upon the policy terms) to directors and officers (insured persons) against "losses" arising from "claims" made against directors and officers during the policy period for "wrongful acts" in connection with their duties as directors and officers. It also usually provides cover for certain legal costs of defence and settlement of claims and representation at certain types of investigations, examinations and inquiries. It responds where the insured organisation is unwilling, unable or refuses to indemnify the director or officer.

Side B cover - provides cover (upon the policy terms) to companies (insured organisations) in respect of indemnities provided by them to their directors and officers against "losses" arising from "claims" made against the directors and officers during the policy period in connection with the directors' and officers' "wrongful acts" committed in their capacity as director or officer.

Side C cover - this cover is not offered in every D&O policy. It provides additional cover (upon the policy terms) for the insured organisation for "losses" arising from "securities claims" made directly against the insured organisation during the policy period in relation to breaches of laws regulating securities.

The definition of "wrongful act" varies from policy to policy but the term is usually defined widely. A typical definition of "wrongful act" includes any actual or alleged breach of duty, breach of trust, neglect, error, misstatement, misleading statement, breach of warranty of authority or other act committed by an insured person or any liability asserted against them solely because of their status as a director or officer. Depending on its terms, a D&O policy may only provide cover for a claim by a third party against directors or officers in connection with a liability that a director or officer incurs to a third party and not cover claims brought by the company or its related companies against directors or officers. However, in recent times, there has been a move towards deletion of the typical 'insured v insured' exclusion in top end policies. Potentially, substantial liabilities may be incurred by a director or officer to a co-insured.

13. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

The following conduct and claims are commonly excluded:

- professional indemnity - claims alleging breach of duty other than duties owed by a director or officer in that capacity (directors and officers who are professionals need to ensure they have professional indemnity insurance for other duties);

- 'insured v insured' - claims brought by one person covered by the insurance against another (including by the company against its directors and officers). (This exclusion is being phased out: see above comment);
- wilful breach of duty;
- contravention of s 182 and s 183 (misuse of position and information);
- prospectus type liability;
- fraud or dishonesty;
- insider trading;
- prior claims and known circumstances;
- bodily injury and property damage;
- US claims;
- consensual claims;
- *Employment Retirement Income Support Act* ("ERISA") (United States legislation); and
- pollution.

BRINGING A CLAIM UNDER THE INSURANCE

14. Who can bring a claim under the D&O cover?

The insured person can bring claims in relation to Side A cover.

The insured organisation can bring claims in relation to Side B and (if applicable) Side C cover.

THE EXTENT OF THE COVER

15. What is the procedure for bringing a claim?

Each D&O policy will usually make provision for claims notification and settlement procedures. The procedure for bringing a claim is generally as follows:

- the insured or its broker notifies the insurer of the claim;
- the insurer considers the claim and may request further and better particulars;
- the insured is generally required to cooperate with the insurer and provide the necessary information to assist the insurer to investigate the claim;
- the insured may have a duty to defend and may appoint solicitors with the insurer's consent;
- pending a decision on indemnification, the insurer may consent to defence costs;
- once indemnity is granted, the insured's duty to defend continues; and
- if the insured is covered, it is best that they involve the insurer in defending the claim. Leading D&O insurers in Australia promote a claims handling function and they will attend settlement, court proceedings and key meetings to facilitate the defence.

D&O insurance policies are "claims made" or "claims made and notified" policies. This means that the policies provide insurance (upon the policy terms) in respect of claims made against an insured during the policy period. The distinction between the two types of policies is that "claims made and notified" policies additionally require notification of the claim to the insurer during the policy period. Either a "claims made" or a "claims made and notified" policy may also contain a "reporting of circumstances" clause. Under such a clause, before the end of the policy period an insured may inform the insurer of circumstances that have the potential to result in a claim being made against the insured in the future so as to attach coverage (subject to the policy terms). A similar right of notification is conferred under the *Insurance Contracts Act* (ss 40(3)). Where such notification is provided, a future claim arising out of the circumstances notified is treated as made during the policy period - notwithstanding it may actually be made after the end of the policy period.

A failure to notify the insurer of a claim, or of circumstances that might give rise to a claim (where required or permitted to do so under the policy terms or statute), can result in the policy not responding in relation to that claim or subsequent claims. Whilst insureds may be able to rely upon s 54 of the *Insurance Contracts Act* (it is expected that this section will be reformed) to redress or alleviate a failure to notify, clearly the prudent approach is to ensure that the insurer is notified of any claims received, or circumstances that are known, at the earliest possible time and in any event before the end of the policy period.

INDEMNIFICATION

16. Can the company indemnify its directors and officers? If so, for what?

Subject to certain specific exceptions, a company may indemnify its directors and officers - though shareholder approval in accordance with the notification and approval procedure in Part 2E.1 will be required in the case of public companies in the absence of an available exemption (as to which refer Q 17 below).

Under ss 199A(2), except for legal costs (as to which refer below), a company and its related companies are prohibited from indemnifying a person, whether by agreement or by making a payment and whether directly or through an interposed entity, against any of the following liabilities incurred by the person as an officer or auditor of the company:

- a liability owed to the company or a related body corporate;
- a liability for a pecuniary penalty order or compensation order under specific sections of the *Corporations Act*;
- a liability owed to someone other than the company or a related body corporate that did not arise out of conduct in good faith[12].

A company and its related companies are also prohibited from indemnifying a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against legal costs incurred by the person in defending an action for a liability incurred as an officer or auditor of the company if the costs are incurred:

- in defending or resisting proceedings in which the person is found to have a liability for which they could not be indemnified under ss199A(2); or
- in defending or resisting criminal proceedings in which the person is found guilty; or
- in defending or resisting proceedings brought by ASIC or a liquidator for a court order if the grounds for making the order are found by the court to have been established. (This does not apply to costs incurred in responding to actions taken by ASIC or a liquidator as part of an investigation before commencing proceedings for the court order); or
- in connection with proceedings for relief to the person under the *Corporations Act* in which the Court denies the relief.

Prohibitions on indemnification - whether by agreement or by making a payment and whether directly or **through** an interposed entity - by a company or related company are also contained in the *Trade Practices Act* in respect of civil penalties imposed for contraventions of Part IV (the restrictive trade practices division). (Refer also Q. 19 below noting proposed amendments of the *Trade Practices Act* and the *ASIC Act*).

The *Trade Practices Act* does not contain a provision that corresponds to s 199B. (As noted in Q 6, s 199B sets out the liabilities for which a company cannot pay an insurance premium - namely, the insurance premium for a policy that provides insurance to an officer against liabilities arising out of a willful breach of duty, misuse of position or misuse of information.) This difference gives rise to a concern that, on a literal reading, the relevant provisions of the *Trade Practices Act* may be construed as prohibiting a company from paying an insurance premium altogether for a policy which includes in its ambit cover for civil penalties imposed for contraventions of Part IV of the *Trade Practices Act* (and associated legal costs in defending or resisting proceedings in which the person is found to have a liability for such) - for the reason the insurer may be an interposed entity. That is to say, if an insurer can be an interposed entity for the purposes of the relevant provision (s 77A), then the company (or a related company) by paying the premium for a policy that provides cover for civil penalties for contraventions of Part IV may be providing an indemnity **through** an interposed entity in breach of the prohibition. The prevailing view appears to be that an arms length insurer who has charged a commercial premium will not be an interposed entity for the purpose of s 77A. This is, however, an issue on which different views may be reasonably held.

One suggestion that has been made to mitigate the risk of breaching s 77A is for a separate premium to be paid by the insured officers themselves (or one or more of them) for cover - which is provided discretely in the insurance policy - for civil penalties in respect of which the company and related companies are prohibited from providing indemnification.

17. How is the indemnification dealt with in practice?

In practice a company may enter into a deed of indemnity with each director. Alternatively (or perhaps additionally) the company constitution may contain an indemnity. The indemnity given is commonly drafted as being given to the maximum extent permissible by law (or to the extent that the company is not legally precluded from giving indemnification) and to the extent indemnification is not provided by an insurer or other third party.

The company's constitution must authorise the company to give an indemnity and pay an insurance premium. If not, the constitution must be amended to give the requisite authority, or the indemnity and premium will need to be approved by the shareholders (as well as conform with the law).

A deed of indemnity in favour of a director is, of course, a contract in which the director has a material personal interest. However, a director is not required to give notice to the other directors of an interest that "relates to any payment by the company or a related body corporate in respect of an indemnity permitted under s 199A or any contract relating to such an indemnity"[13]. Notwithstanding this, because deeds of indemnity involve the conferral of financial benefits, where public companies are involved, shareholder approval in compliance with the notification and approval procedure contained in the "related parties and financial benefits" regime[14] will be required where there is no available exemption. In this respect ss 212(1) (noted in Q 7 above) also exempts an indemnity (or an agreement to indemnify) in favour of a related party who is an officer or auditor of a public company or an entity controlled by a public company for liabilities incurred in that capacity if giving the benefit is reasonable in the circumstances of the public company or entity giving the benefit.

ANY OTHER BUSINESS

18. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No

19. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

On 24 June 2009, the *Trade Practices Amendment (Australian Consumer Law) Bill* 2009 (Cth) ("**Bill**") was introduced to amend the *Trade Practices Act* and the *ASIC Act*. The *ASIC Act* is proposed to be amended to include provisions mirroring sections of the *Trade Practices Act* regarding the indemnification of officers but in respect of civil penalties imposed for contraventions of the provisions of the *ASIC Act* dealing with unconscionable conduct, consumer protection and substantiation notices (and associated legal costs in defending or resisting proceedings in which the person is found to have a liability in respect of such).

The Bill also amends the *Trade Practices Act* to include a prohibition on the indemnification of a person for civil penalties imposed in respect of contraventions of any civil liability provisions under the Trade Practices Act (and associated legal costs in defending or resisting proceedings in which the person is found to have a liability in respect of such).

20. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Gaps arise due to the different nature of cover provided by D&O insurance and company indemnities. Generally speaking, the cover provided to directors and officers by company indemnities is expressed in broader terms than the cover provided by insurance policies. Whereas an indemnity may provide cover, to the extent permitted by law, for 'all liabilities' relating to the director or officer's service, D&O insurance policies typically confine the policy response to prescribed events and losses which are defined in more restrictive terms. Typical areas in which gaps in cover arise are:

- fines and penalties;
- costs not related to a claim under the D&O policy (for example, legal costs in determining whether or not the director or officer is entitled to indemnification, and the personal costs of directors and officers in assisting the company); and
- liabilities under s 199A and s 199B.

Consideration should be given to the adequacy of side C cover limits. There is in any event an issue as to the appropriateness of including Side C cover in a D&O policy. Concerns may arise regarding the potential for Side C claims to erode the available policy limit.

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[1] This publication is only a general outline. It is not a legal advice. You should seek professional advice before taking any action based on its contents.

[2] s 9 *Corporations Act 2001 (Cth)*. Section references are to the *Corporations Act* unless otherwise specified

[3] s 9

[4] as defined: Part 2E.2 *Corporations Act*

[5] ss 208(1)

[6] ss 191(1)

[7] ss 191(2)

[8] Part 2E.1

[9] s 21 *Insurance Contracts Act 1984 (Cth)*

[10] s 28 *Insurance Contracts Act*

[11] *s 48 Insurance Contracts Act* - provided the Act applies to the insurance contract. In addition, where the governing law of the insurance contract is local law, the common law confers a right to enforce the insurance contract directly.

[12] ss 199A(2)

[13] ss 191(2)(a)(vii)

[14] Part 2E.1

Australia 2

MARK KIMBERLEY AND LOUISE CANTRILL, HENRY DAVIS YORK

Directors and Officers Duties and Obligations

In Australia there are two types of companies: proprietary companies and public companies. A public company is one that can offer its shares to the public and, therefore, is able to be listed on the Stock Exchange. This survey is limited to directors and officers' duties and obligations with respect to public companies only, although many of the duties and obligations apply equally to both forms of company.

The Corporations Act 2001 (Cth) (the Act) is the primary national legislation regulating companies, financial products and directors and officers.

Directors and Officers Duties and Obligations

Section 9 of the Act defines "director" as:

(a) a person who:

  (i) is appointed to the position of a director; or

  (ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; and

(b) unless the contrary intention appears, a person who is not validly appointed as a director if;

  (i) they act in the position of a director; or

  (ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Section 9 of the Act also defines "officer" of a company as:

(a) a director of secretary of the company; or

(b) a person:

  (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or

  (ii) who has the capacity to affect significantly the corporation's financial standing; or

  (iii) in accordance with those instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors of the corporation); or

(c) a receiver, or receiver and manager, of the property of the corporation; or

(d) an administrator of a corporation; or

(e) an administrator of a deed of company arrangement executed by the corporation; or

(f) a liquidator of the corporation; or

(g) a trustee or other person administering a compromise or arrangement made between the corporation and someone else.

For the purposes of this survey, reference to directors includes a reference to officers unless otherwise specified.

Directors are responsible for the management and control of the company[1]. As a result, directors are bound by strict legal duties, both at common law and under statute. These duties are owed to the company as a whole and, ultimately, to its shareholders. However, as will be illustrated below, duties also extend, in certain circumstances, to third parties, including employees, creditors and the State.

The duties imposed under common law include the duty to act in good faith, the duty to avoid a conflict or interest and the duty to exercise pose for a proper purpose.

These common law duties have been incorporated into the Act. In particular, Part 2D of the Act provides that directors must exercise their powers and discharge their duties:

- with the degree of care and diligence that a reasonable person holding a similar position would have done in the same circumstances;[2]
- in good faith in the best interests of the corporation and for a proper purpose.[3]

Furthermore, directors must not improperly use their position or information obtained in their position as a director to gain an advantage for themselves or someone else or cause detriment to the corporation.[4]

In addition, directors may be criminally liable if the breach of the directors' duty of good faith or the breach of the directors' use of position and/or company information was reckless or intentionally dishonest.[5]

In circumstances where a director has a material interest in a matter that relates to the affairs of the company, the director is required to give the other directors notice of the interest.[6] The notice must include details of the nature and extent of the interest and be given at the directors' meeting as soon as practicable after the director becomes aware of potential conflict of interest in the matter.

Where a corporation is a trustee, directors can be both individually and jointly liable with the corporation for debts and other obligations incurred by the corporation as trustee in circumstances where the debts have not been discharged and the corporation cannot discharge its obligations.[7] This section provides a statutory form of "lifting the corporate veil" between trustee companies and their directors.

Directors are also required to take all reasonable steps to ensure compliance with the requirements of the Act relating to the preparation of financial statements.[8]

In addition, where an administrator has been appointed to a company, a director is under a duty to give the administrator all books and information about the company's business, property, affairs and financial circumstances as the administrator reasonably requires.[9]

The Act imposes a duty on a director to avoid insolvent trading by the company by providing that a director may be personally liable if a company is, or is about to become, insolvent and the directors fails to prevent the company from incurring additional debt.[10] This duty does not extend to officers of a company. A breach of this duty can attract both civil and criminal liability.

Section 230 of the Act provides that directors are not relieved from any duties under the Act, or their fiduciary duties, in connection with a transaction merely because the transaction was authorised by a provision of Chapter 2E (Related Party Transactions) of the Act or is approved by a resolution of members under a provision of Chapter 2E of the Act.

Directors' Duties to Creditors

Directors' duties are not ordinarily owed to creditors (*Spies v The Queen (2000) 201 CLR 603);* or employees (*Parke v Daily News Ltd* [1962] Ch 927). However, s558G of the Act imposes an obligation to have regard to the interests of creditors. Section 596B imposes an obligation to have regard to the interests of employees and provides that directors will be liable for a breach of their duty if they enter into any agreement or transaction that deliberately prevents employees from recovering their entitlements from the company or significantly reduces the amount of their entitlements as employees.

Penalties under the Act

Part 9.4B of the Act deals with civil consequences of contravening civil penalty provisions. These include breaches of ss181-183, 344 and 588G of the Act. Part 9.4B provides that a court may impose fines up to $200,000 (s1317G), order disqualification from management (s206C), and require payment of compensation (ss1317H and 1317HA). Section 1317S provides relief from civil liability if the Court finds that the director has acted honestly, and having regard to all the circumstances, ought to be excused.

If found guilty of failing to exercise their powers and discharge their duties in good faith and in the best interests of the corporation, or for a proper purpose, directors may be fined up to $200,00 and/or imprisoned for up to five years.

Directors' obligations under other legislation

There are additional obligations imposed on directors under other Australian statutes, both federal and state. For example, section 169 of the *Protection of the Environment Operations Act 1997* (NSW) (PEOA) provides that where a corporation contravenes a provision of the PEOA then each director is taken to have contravened the same provision and automatically deemed to have committed the same offence.

Under the *Income Tax Assessment Act 1936* (Cth), a director of a company may be personally liable if the company fails to make specified deductions (including for group tax) or if the director has aided or abetted in the commission of an offence by the company.

Under section 26(1) of the *Occupational Health and Safety Act 2000* (NSW) (OHSA) if a corporation contravenes a provision of the OHSA then each director is taken to have contravened the same provision unless the director satisfies the court that:

- he or she was not in a position to influence the conduct of the corporation in relation to its contravention of the provision; or
- he or she, being in such a position, used all due diligence to prevent the contravention by the corporation.

D&O Insurance

Australia has a sophisticated market for directors and officers (**D&O**) insurance. It is common for a public company to purchase D&O insurance cover for its directors.

A standard Australian D&O insurance policy contains two separate parts: a direct cover component which indemnifies directors for wrongful acts committed by directors in the conduct of their duties (known as side A cover) and a company reimbursement component which reimburses the corporation for any (lawful) indemnity which the corporation may grant to its directors for their liability for alleged wrongful acts undertaken in their capacity as directors (known as side B cover). Some D&O policies also have an insuring clause (known as side C cover) which covers the company for loss which it is legally obligated to pay for some types of claims made against it which arise from the company's dealings with its securities.

The Act imposes certain restrictions on indemnity and insurance payments. In particular, section 199A(2) of the Act prohibits a company from indemnifying a person against any of the following liabilities incurred as a director of the company:

- liabilities owed to the company or a related body corporate;
- liabilities for compensation orders or civil penalties; and
- liabilities to third parties which did not arise out of conduct in good faith.

Further, section 199B of the Act provides that a company is prohibited from paying or agreeing to pay the premium for insurance of a director against a liability (other than for legal costs) arising out of:

- conduct involving a wilful breach of duty in relation to the company; or
- a contravention of sections 182 or 183 of the Act (which relate to a director's use of position and use of information).

Although a company is not required to provide its directors with D&O insurance, it is common for directors or large public companies to insist upon the availability of D&O insurance before taking office. The only requirement under the Act is that details of any indemnity given or insurance premium paid must be included in the annual directors' report.

With respect to the purchase of the D&O cover, section 21 of the *Insurance Contracts Act 1984* (Cth) requires that the insured parties provide disclosure to the insurer. Good corporate governance should require the disclosure by the

company and its directors of all matters relevant to the insurer's decision to provide cover.

D&O cover can be purchased locally from a number of Australian authorised providers of D&O insurance, but the market is relatively small.

Recent legislative and regulatory changes now require that foreign insurers, being not authorised to conduct insurance business in Australia, are prohibited in Australia unless they are authorised to exempt. Notwithstanding this, some public companies may still be permitted to purchase D&O cover from unauthorised foreign insurers where the following specified exemptions permit:

- High value insured exemption. The high-value insured exemption allows Australia's largest business and global companies headquartered in Australia to use foreign insurers as part of their risk management frameworks and to cover their global risks. It recognises that high-value insureds are likely to be sophisticated purchasers of general insurance with complex risks that may not be able to be covered solely through authorised insurers;
- Atypical risks exemption. This exemption recognises that there are a number of limited, specific atypical insurance risks, i.e. nuclear, biological, war, terrorism, medical clinical trials etc that currently cannot be placed, on a stand-alone basis, with authorised insurers. Some risks are covered in a global market by a very limited number of global insurers. For other risks, while there may be limited local cover available, there may not be sufficient capacity to satisfy local demand or the cover may only be available if bundled with other risks; or
- Customised exemption for risks that cannot reasonably be placed in Australia.

In summary, Australian directors have a number of duties imposed on them in their role in managing and controlling a company. D&O insurance is generally available to protect directors against losses arising from liabilities incurred by them in connection with their duties, as long as the breach of duty giving rise to the liability is not wilful or dishonest.

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1 *s198A Corporations Act 2001 (Cth)*

2 *s180(1) Corporations Act 2001 (Cth)*

3 *s181(1) Corporations Act 2001 (Cth)*

4 *s182(1) and 183(1) Corporations Act 2001 (Cth)*

5 *s184 Corporations Act 2001 (Cth)*

6 *s191(1) Corporations Act 2001 (Cth)*

7 *s197 Corporations Act 2001 (Cth)*

8 *s344 Corporations Act 2001 (Cth)*

9 *s438B Corporations Act 2001 (Cth)*

10 *s588G Corporations Act 2001 (Cth)*

Australia 3

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Addendum Note on "Side C" cover

In Australia there has recently been a heightened interest in the issues associated with cover for securities claims under directors' and officers' liability insurance policies ("D&O policies"). Entity securities claims cover (or "Side C" cover) has emerged in the last decade or so. It allows companies to claim indemnity under D&O policies in relation to securities claims made against the company. This expands the traditional scope of D&O policies beyond the protection of directors and officers (for convenience, "directors"). While initially seen as a benefit to address the growing number of shareholder class actions, Side C cover has come with its own problems. Side C cover has in many cases been under the same limit of liability as the directors' and officers' liability and company reimbursement covers. If a claim is made by the company under the Side C cover, directors are exposed to the risk of their insurance cover being reduced or eroded completely. This is particularly concerning when the policy is required to respond in a number of ways to the conduct which gave rise to the securities claim.

This note gives a brief overview of how Side C cover operates in Australian D&O policies, the causes of action to which the cover responds, use of the cover in class action settlements and the response of D&O insurers to concerns over the incorporation of the cover in D&O insurance policies

What is "Side C" Cover?

Traditionally D&O policies have provided two covers, both to ensure the ultimate protection of directors. First, Directors' and Officers' Liability cover (or "Side A" cover) which provides indemnity in relation to claims made against directors and officers arising out of their wrongful acts for which they are not indemnified by the company. Second, Company Reimbursement cover (or "Side B" cover) to reimburse the company for amounts which it is legally permitted to pay to a director as indemnity against liability for their wrongful acts.

Side C cover, in broad terms, provides indemnity to the company (and its subsidiaries) for claims against the company alleging breach of laws relating to securities bought by a person or entity that arise out of the purchase, sale, or offer of any securities. The company is the insured and the cover may be triggered irrespective of any wrongful conduct on the part of a director.

What claims are typically made under Side C cover?

Australia has a sophisticated corporations law regime under the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth). The legislation contains a number of causes of action against a company relating to the issue and distribution of a company's securities. These relate to:

- breach of continuous disclosure obligations (if the company fails to notify the market of information that is not generally available and which is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of an entity's securities);
- prohibitions on omissions from prospectuses; and
- prohibitions on misleading and deceptive conduct in the share market.

The rise of class actions and the use of Side C cover

Australia has experienced a surge in the number of securities claims in the last few years. This has been influenced by a number of factors including:

- new causes of action based on misleading and deceptive conduct and the continuous disclose regime;
- procedural rules that make it easy to commence class action proceedings; and
- the High Court's approval of litigation funding.[1]

One of the significant cases that, arguably, arose from the confluence of these factors was the *Aristocrat* class action[2]. The case involved a shareholder class action against Aristocrat, a gaming machine manufacturer, in which the claimants alleged that the company had misled its shareholders by overstating its profits and failing to disclose that it would not meet its earnings forecasts[3]. It was settled for approximately $145 million. In Australian terms, this was a large settlement for a claim of this nature. Notably, Aristocrat announced that it would fund $40 million of the settlement amount. It is presumed that the balance was covered by insurance. The most likely insurance to respond would be a D&O policy. This may not otherwise be significant, but for the fact that the directors were not parties to the proceedings[4]. If the insurance which responded was the D&O policy, it was probably on the basis of a claim by Aristocrat under Side C cover. The pay out would likely have eroded a significant amount of cover otherwise available for directors. Not only does the settlement sound a warning of how expensive securities claims can be for a company, it also highlights the risk of having Side C cover under the same limit of liability as the Side A and Side B covers in a D&O policy.

What are some of the key issues relating to Side C cover?

Side C cover is usually written under a separate insuring clause in the D&O policy, alongside the Side A and Side B covers. There is generally one limit of liability across all covers. The consequence of this is that any claim made by the company under Side C can erode the limit of liability that is available to meet claims made under Side A and Side B. The disadvantage for directors is self-evident.

A further complication arises out of the exercise by directors of their duties. As the directing mind of the company, the board of directors may be called on to cause the company to make a claim under Side C. When the board considers issues arising out of the Side C claim, it arguably places the directors in a position of conflict. Any decision not to pursue a Side C claim will indirectly benefit the directors by preserving the limit of indemnity available under the other covers. A conflict of this nature may arise at various stages and, most significantly, if the directors are simultaneously seeking indemnity under the policy (e.g. if they are joined in the securities claim proceedings against the company).

Finally, there is the potential for the company's right to claim under Side C in respect of its own liabilities to turn the policy into an asset of the company. If the company fails, the policy may be susceptible to attachment by a liquidator. In these circumstances, there will be little prospect of the directors obtaining advancement of defence costs as the liquidator is likely to assert an entitlement to the policy proceeds for the benefit of creditors.

Responses by D&O insurers

The initial response of D&O insurers to directors' concerns over Side C cover eroding limits of liability for directors was to include priority of payment clauses. These give the directors the right to receive indemnity under the policy in preference over the company, i.e. the directors' claims would be paid before a claim of the company would be paid. However, such clauses are only effective if claims have been made against both directors and the company. Furthermore, the timing of the respective claims of the company and the directors is critical. If the company makes a claim under Side C ahead of claims by the directors under the other covers, and its liability is determined and entitlement to indemnity crystallizes before that of the directors, the company may be entitled to receive its indemnity irrespective of the order of payments clause.

Other alternatives to limit the impact of Side C cover have included imposing a sub-limit of liability in respect of that cover and purchasing excess insurance for the Side A cover.

More recently, Australian D&O insurers are looking to separate out Side C cover from standard D&O policies. The availability of separate securities claims or Side C cover is a meaningful response to the concerns of directors. It remains to be seen whether the cover will be embraced by the market.

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1 M J Legg, "Shareholder Class Actions in Australia - The Perfect Storm?" (2008) 31(3), *UNSW Law Journal*, p. 670

2 For further information on the proceedings see *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2008] FCA 1311

3 See Sixth Further Amended Statement of Claim, *Dorajay Pty Ltd v Aristocrat Leisure Limited*, Federal Court of Australia No. N362 of 2004 (http://www.mauriceblackburn.com.au/aristocrat/Sixth_Further_Amended_Statement_of_Claim.pdf) (Accessed 30 June 2009)

4 There does not appear to have been any claims maintained against the directors of Aristocrat. See IMF Australia, "The Shareholder - Biannual Newsletter" (2009) March, Issue 7, p. 3; and M Legg and N Mavrakis, "Australia's Largest Shareholder Class Action Settles" (2008) 238, *Sweet & Maxwell's Company Law Newsletter (UK)* 1.

Belgium

HUGO KEULERS, LYDIAN LAWYERS

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Under Belgian law, D&O liability includes members of the board of directors, the management committee and the persons responsible for the daily management, "shadow directors" and "former directors". Shadow directors are individuals who exercise within the company an activity of leadership and management, without formally holding a seat in the board of directors. Former directors are individuals who used to hold a seat on the board of directors at the time an alleged liability act occurred, but are no longer director when the liability issue arises or when the liability claim is made.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(1) Directors, members of the management committee and the persons responsible for the daily management are responsible towards the company for the execution of their mandate. Therefore, they can be held liable for any shortcomings in the performance of their duties (art. 527 of the Belgian Companies Code, hereafter referred to as the BCC).

A valid discharge of liability given by the annual general meeting of shareholders however frees the directors of their contractual liability towards the company for management errors or negligencies during the past financial year.

(2) Directors and members of the management committee can also be held jointly and severally liable for all damages resulting from a breach of the company's articles of association or the provisions of the BCC (art. 528 BCC).

If the aforementioned breach is certain, a presumption of fault applies. A director can only escape his liability if he proves that he did not take part in the breach and if he denounces the breach at the first general meeting of shareholders that takes place after he becomes aware of the breach.

(3) Directors and members of the management committee who have a direct or indirect conflicting patrimonial interest in a certain transaction and who have obtained a wrongful advantage through such transaction can be held liable to the extent of the damages suffered by the company as a result of the transaction.

(4) Directors, members of the management committee, persons who exercise the daily management, former directors and shadow directors can be held liable for certain criminal offences, such as abuse of company assets (article 492bis Belgian Criminal Code).

(5) A breach of a legal provision or of the general duty of care in the exercise of the director's mandate, as a result of which the company suffers damages, can lead to the liability of the director based on art. 1382-1383 Belgian Civil Code (non-contractual liability).

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are no specific duties of the Directors and Officers to shareholders. Since shareholders are considered third parties, we refer to question 3 below.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(1) The directors and the members of the management committee can be held liable for all damages resulting from a violation of the company's articles of association or the provisions of the BCC (art. 528 BCC).

The presumption of fault, as explained under question 2.2, also applies here.

(2) The directors, as well as the shadow directors and the former directors, can also be held liable for "blatant serious fault" in case of bankruptcy (art. 530 §1 BCC). When the company goes bankrupt, the directors can be held liable for the whole or a part of the debts of the company which exceeds the asset value, if it is certain that the directors committed a blatant serious fault that contributed to the bankruptcy.

This claim can be introduced by any aggrieved creditor. If a creditor decides to introduce this claim, he needs to inform the receiver to give him the opportunity to decide whether to introduce the same claim on behalf of all the creditors.

(3) Every violation of a legal provision or carelessness in the exercise of the director's mandate, by which a third party suffers damages, can lead to the liability of a director based on art.

1382-1383 Belgian Civil Code (cfr. above under question 2).

A director who executes a company's contractual obligation can however only be held liable if he violates the general duty of care and if the damages, for which indemnity is sought, can be interpreted as a different damage than the one that results from the shortcomings in the execution of the agreement.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(1) Liability for unpaid social security contributions in case of bankruptcy (article 530 §2 BCC). When the company goes bankrupt, the directors, the former directors and the shadow directors can be held jointly and severally liable by the public social security authorities for the whole or a part of the social security debts of the company if they committed a serious fault which caused the company's bankruptcy or if they are in a situation as described in article 38 §3 octies 8°of the law of 29 June 1981 containing the general principles of social security for employees.

(2) Liability for unpaid social security contributions outside bankruptcy (article 40ter of the act of 27 June 1969). The employer who has not paid social contributions for two quarters during the last twelve months and who has not obtained an amicable settlement needs to inform the collection institution, at it's simple request, of the outstanding amounts which these clients and third parties still need to pay. If the directors refuse to give this information or provide false information, they can be held liable by the collection institution.

(3) Liability for unpaid withholding tax and VAT (article 422quater resp. article 93undecies C VAT Code). If a company does not abide by its obligation to pay withholding tax, VAT, taxes, interests or extra costs, the company's director(s) and daily manager(s) can be held liable if the shortcomings are due to a fault within the meaning of article 1382 Belgian Civil Code, committed during their management of the company.

(4) Liability under article 1382 of the Belgian Civil Code (see question 2 above).

(5) Criminal liabilities. Directors can be held liable for certain criminal offences, such as:

- Crimes relating bankruptcy (articles 489 and following of the Belgian Criminal Code).
- Abuse of company assets (article 492bis Belgian Criminal Code).
- Bribery (article 504bis Belgian Criminal Code)

(6) Under Belgian law, the company itself, as a legal person, can also be held liable for criminal offences. However, given that a company always acts through physical persons who are part of the board of directors, the liability may also lie with the directors. Regarding unintentional criminal offences, only who committed the most serious fault will be condemned. With respect to intentional criminal offences, the company and the director(s) can both be condemned if the company and the natural person(s) have, knowingly and willingly, committed the criminal offence.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Since employees are considered third parties, we refer to question 3 above.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Several of the liability claims explained above can also be introduced by the trustee in case of bankruptcy. Directors can be held liable for the following:

(1) Liability for the execution of their mandate and liability for shortcomings in the management of the company (art. 527 BCC).

(2) Liability for all damages resulting from a breach of the articles of association or the provisions of the BCC (art. 528 BCC).

(3) Liability for an obvious serious fault in case of bankruptcy.

(4) Liability for unpaid social security contributions in case of bankruptcy. The directors can be held liable for the whole or a part of the social security contributions, contribution increases, late payment interests etc., that are outstanding at the moment the company is declared bankrupt. In this case, as explained above, serious fault is presumed.

(5) Liability for unpaid social security debts, unpaid withholding tax and VAT.

(6) Liability based on article 1382 of the Belgian Civil Code.

8. What remedies are available?

Award of damages, fines and occasionally imprisonment in case of criminal offence.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

9. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Purchase of D&O insurance is legal under Belgian law and is more and more common for Belgian companies.

The policyholder of a D&O insurance is always the company itself. It enters into the insurance contract for the benefit of its directors who will be the insured persons. The directors themselves cannot individually purchase a D&O insurance contract for themselves.

10. Are there any corporate procedural prerequisites to effecting cover?

A decision of the board of directors is required prior to purchasing cover for the directors. The decision to purchase D&O cover can cause a situation of conflict of interest, since the directors will have to decide on the cover of their own liability. Consequently, the conflict of interest procedure of articles 259 and 523 BCC will need to be followed.

11. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

The policyholder will, at the time of inception of the policy, meticulously report to the insurer all known circumstances which he must reasonably consider to be material for the assessment of the risk by the insurer. However, he does not have to disclose those circumstances that are already known or should be known by the insurer.

Fraudulent non-disclosure, fraudulent disclosure and non-fraudulent disclosure are sanctioned under Belgian law.

D&O insurers generally ask the potential policyholders to fill in a questionnaire regarding a.o. the form of the company, its financial situation, its M&A policy, eventual previous condemnation of the directors, etc.

12. Are there any tax implications connected to the purchase of D&O cover?

In Belgium, case law decided that the purchase of D&O cover cannot be regarded as a taxable benefit for the directors and officers.

13. Is insurance of D&O exposures compulsory in respect of any type of company?

D&O insurance is not compulsory under Belgian law.

14. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance is usually purchased locally. Many of the insurers present on the Belgian market do offer D&O insurance products.

As the Belgian reinsurance market is rather reduced (one single reinsurer, Secura Re), it is extremely common that the insurers active in Belgium for D&O insurance business obtain reinsurance protection from the London market or from an overseas market.

THE EXTENT OF THE COVER

15. Who are the beneficiaries of the insurance?

Under Belgian law the insureds under a D&O policy are the individual directors and officers. All directors and officers are covered by a D&O policy (i.e. members of the board of directors, the management committee and the persons responsible for the daily management, “shadow directors” and “former directors”. In certain cases, husband/wife of the directors, or the directors’ heirs or legatees can be insured under a D&O policy).

When a director has a mandates in another company (“external mandate”), he is covered by the D&O insurance of his company.

In practice, it is rather common that a holding company concludes a D&O insurance for its own directors and officers, but also for the directors and officers of its subsidiary companies and/or its joint ventures in which it holds at least 51%.

16. What is commonly covered?

D&O insurance covers the civil liability of directors and officers (contractual and non-contractual liability) as a result of their activities as directors or officers of the company.

Costs incurred for civil and criminal defence of the directors or officers are also covered.

17. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Under Belgian law, fraud of the insured is excluded, such as the non-respect of certain obligations imposed to the insured by the insurance contract.

Under D&O insurance in particular, personal injury and professional liability are not covered (these are covered by other types of insurance concluded by the company). Pollution is traditionally not covered by a D&O insurance, nor are conviction to criminal, administrative or tax fines.

Claims introduced in the USA or in Canada (punitive damages) are commonly excluded.

BRINGING A CLAIM UNDER THE INSURANCE

18. Who can bring a claim under the D&O cover?

In most Belgian D&O policies, the company itself may claim under the D&O cover provided its claim is in writing and "serious". Third parties may file directly a claim against D&O insurers on the basis of Article 86 of the 25 June 1992 Statute on non-marine insurance contracts.

19. What is the procedure for bringing a claim?

The general conditions of D&O insurance will explain the procedure to be followed, including maximum period to notify a claim to the insurer, documents to be transmitted to the insurer, evidence to be kept by the company, etc.

INDEMNIFICATION

20. Can the company indemnify its directors and officers? If so, for what?

(1) In Belgium, it is not yet determined if a warranty agreement between a company and its own directors is valid, except when it is signed with third parties such as individual shareholders or the parent company. An agreement with the directors of subsidiary companies is however considered to be valid.

(2) A group can subscribe an insurance policy for all directors of the mother and subsidiary companies. An extra guarantee for non-covered damages and/or non-ensured limits is provided by a warranty letter, subject to the company being solvent and the letter being legally valid.

21. How is the indemnification dealt with in practice?

When a valid warranty agreement has been signed, the company will first indemnify its directors or officers. Some D&O insurance policies will provide for indemnification of the company itself, that has indemnified its own directors and officers. In this case, the deductible will be applied to the company.

22. To what extent is corporate governance utilised to shield directors and officers?

The Belgian code on corporate governance does not aim to shield directors and officers. On the contrary, most rules intend to improve the independency, responsibility and objectivity of the board members. However, we often see that companies implement a so-called "delegation plan" which may be integrated in a company's governance charter, to make sure that the right and most competent persons (whether directors or not) are given the tasks which best fit with their areas of competence and expertise and that a certain portion of the decision-making process is delegated to them in these areas.

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

Belgium does not anticipate any legislative or regulatory changes regarding D&O liabilities.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

Belgium does not anticipate any legislative or regulatory changes regarding the legality of cover/indemnification.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Under Belgian insurance law, a third party has a direct claim against the liability insurer of the liable person (Article 86 of the 25 June 1992 Statute on non-marine Insurance contracts).

Victims of a "management fault", i.e. a fault committed by a director or officer as a result of their activities as directors or officers of the company, can directly claim indemnification from the D&O insurer, without first claiming indemnification from the director/officer himself.

The amount of case law on D&O liability in general and D&O insurance in particular is very limited. This is because (i) D&O insurance is not always in place and (ii) many D&O claims get settled under confidential terms and conditions not disclosed to the public.

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Chile

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Under the Chilean Corporations Act (Law 18,046/81), the board of directors represents the corporation in all matters and is empowered with broad and sufficient capacity to administer the corporation in all matters that do not expressly require shareholders approval under law or pursuant to the corporation memorandum and articles of association. Regarding limited liability partnership companies, the partnership deed will set out how the partnership is to be managed. Management powers may be exercised by one or more of the partners, a board of directors or by a third party.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

2.1 Directors

The Chilean Corporations Act law establishes various obligations and duties of the board of directors and of each of its members. Many of these legal obligations serve to protect the shareholders of the corporation, and in particular, the minority shareholders.

These obligations can be separated into the following two groups:

2.1.a Duty of Care

Each director must carry out his or her duties with due care and diligence. Each director is jointly and severally liable for any harm or damage suffered by the corporation and/or its shareholders by their negligent or culpable actions or omissions.

2.1.b Duty of Loyalty

Each director must place the interests of the corporation over and above his or her personal interests or those interests of related persons. Furthermore, a director has a duty of loyalty to the company itself and may not pretext of defending the interests of a particular group of shareholders at the expense of the best interests of the corporation.

The duty of loyalty includes:

- The prohibition on undertaking an action that is not in the best interest of the corporation as a whole.
- The prohibition on entering into situations where there is a conflict of interests. The director must inform the board of a possible conflict of interests and abstain from participating in the deliberation and voting on issues if there is a conflict.
- The prohibition on making undue use of corporation assets for personal benefit.
- The prohibition on taking advantage of business opportunities of which the director becomes aware and that could reasonably be of interest to the corporation, without first presenting these opportunities to the corporation.
- The prohibition on taking on positions at entities which could reasonably compete with the corporation.
- The duty of confidentiality.

Where one or more directors of a corporation has an interest in a particular matter, the corporation can only enter into such matter if any interests of the director or directors have been declared before the board and approved and the proposed transaction has terms and conditions considered to be equitable and to reflect similar transactions in the applicable market.

Members of a board of directors of a corporation who are found to have breached the rules set out above and have caused harm or damage to the corporation, are personally jointly and severally liable to the company and its shareholders.

The obligations noted above are established by law and may not be reduced or eliminated by the Memorandum and Articles of Association of the company or by any other agreement among the company and its shareholders.

2.2 Officers

First, it is worthy to note that as per the Chilean Corporations Act, the board of directors may not delegate all its powers and can only delegate to managers, assistant managers, lawyers or members of the board, although delegation to other persons is possible for specifically determined purposes. In this context, managers and main officers are subject to same duties pointed out for directors in section 2.2. above, if compatible with the responsibilities relating their position.

Notwithstanding the above, as per same law the General Manager represents the corporation judicially with all the faculties relating judicial POAs as set forth under the Chilean Procedural Code.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Be referred to sections 2.1 and 2.2 above. In addition, please note that regarding insurance or reinsurance companies, the Directors and officers who perform acts or allowed operations considered as forbidden by the Chilean Insurance Act are personally liable with their own assets for losses caused to these companies, which is notwithstanding of criminal liability.

Are there any exemptions from or liability?

In Chile directors can be exempted from liability relating acts of the board if they express their opposition in the corresponding minute of the board of directors meeting.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to the Chilean Corporation Act, director and officers are liable for any act, omission or contract that can cause prejudice to the company or third parties. Regarding criminal liability, corporation can not be charged for such liability but their directors, officers and attorneys-in-fact can be charged, as the case may be.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The main duties/liabilities to the State can be summarised as follows:

(a) Informing the Chilean tax authority (the "SII") in connection to any petition relating the company taxes.

(b) Informing the Chilean Securities and Insurance Superintendency (the "SVS") about any relevant information relating the company, directors and majority shareholders and/or acts performed by the company with related parties or subsidiaries.

(c) Criminal liability for any wrongdoing regulated under Chilean law.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to Chilean labour law the managers, administrators or other people performing administration functions on behalf of a company can represent the latter as employer before employees, depending on the case. In addition, directors and officers can be liable in cases where safety of employees can be affected or in cases of sexual harassment against an employee.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to the Chilean bankruptcy law, Directors and Officers are obliged to provide any information required by the trustee.

8. What remedies are available?

The Chilean bankruptcy law establishes a list of acts or contracts which are not enforceable against the bankruptcy state if carried out by the debtor during the so-called "suspected period" (period prior to the declaration of "cessation of payments" during which there is a legal presumption of intentional detriment to the creditor's body).

9. Who has the right to claim?

Generally speaking, the right to claim belongs to anyone who holds a creditor position.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

In Chile, the purchase of insurance to cover the liabilities of the D&O is legal and it can be taken out by anyone with insurable interest.

11. Are there any corporate procedural prerequisites to effecting cover?

No unless otherwise established in the company by-laws (not common).

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Chilean law recognises the concept of utmost good faith and obliges the insured to comply, among others, with the legal obligation to sincerely state all necessary circumstances for identifying the subject matter insured and appreciating the risk extension. If not, in Chile an insurance/reinsurance contract may be avoided for false or erroneous statements or concealment by the insured of circumstances which, if known by the insurer, could make it back away from executing the contract or otherwise introduce substantial modifications to its terms and conditions.

13. Are there any tax implications connected to the purchase of D&O cover?

In Chile there are no special tax implications for the purchase of D&O Coverage.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

In Chile there are no specific companies subject to compulsory insurance of D&O exposure. However, insurance and reinsurance brokers are obliged to contract general errors and omissions coverage.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O is usually purchased locally but frequently reinsured with overseas markets.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

Except when using registered policy forms with the regulator, in Chile there are no specific regulatory restrictions as to who can be the insured and/or beneficiary of D&O coverage.

17. What is commonly covered?

Generally speaking, D&O insurance is contracted to provide indemnity for liabilities incurred by directors and officers as a result of their acting in the course of the business of the company. Like in other countries, D&O insurance usually covers judgment or settlement amounts, legal and other defence costs, liability for labour claims, violations to legislation for negligent acts, pollution liability, losses and fines.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

First, as a matter of Chilean law the insured-matter must be of licit commerce. Otherwise, the insurance is not valid. As to specific exclusions, there is freedom of contract.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

In Chile anyone who appears as insured or beneficiary can bring the claim under D&O cover.

20. What is the procedure for bringing a claim?

In Chile if a claim arises it must be notified in the agreed terms to the insurer. If so, such claim will normally be adjusted by a registered adjuster with the Chilean insurance regulator ("SVS") as per the compulsory provisions contained in the Chilean adjustment regulations (DS 863/89), which regulates the activities of both insurance brokers and adjusters.

It is worthy to note that in Chile adjusters are natural or juridical persons registered as such with the SVS, and may be hired by an insurer for a triple purpose, namely:

- to investigate the occurrence of losses and their circumstances;
- to determine whether they are covered or not by the policy wording; and
- to assess the proportion of the settlement amount that must be paid to the insured or beneficiary.

In those losses in which problems and difference in criteria arise during the adjustment process regarding the cause, risk evaluation or extent of coverage, the adjuster, acting ex-officio or upon the insured's request, can issue a preliminary adjustment report in respect of policy cover and the extent of damage. This must be simultaneously issued to the interested parties. The insured or the insurer may make comments in writing on the preliminary report, within five days of receiving it.

Notwithstanding the above, the adjuster has 90 consecutive days from the notice of the loss to issue his or her final report. Should there be qualified grounds, this period may be extended successively by the adjuster for similar periods as long as the SVS does not object. Once the adjuster's report is received, the insurer and the insured have 10 days to lodge any objections. If the adjuster's report is challenged, the adjuster will have 5 days to respond to the objection. Once the objections are answered, the insured and the insurer, if applicable, will have a 5 day term to express their views and, if an agreement is reached, the insurer will immediately pay the insurance claim, if appropriate.

If the insurer and the insured do not reach an agreement on the insurance claim amount or its merits, the insurer must officially notify the insured. The insurer must also tell the insured that the latter is entitled to make use of the procedure, if any, in the insurance policy, to demand payment of the insurance claim or to settle the issues that may persist.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

No. Under Chilean law whatever stipulation in the company's by-laws or shareholders agreement in order to

limit or free directors from their liabilities to the company is null.

22. How is the indemnification dealt with in practice?

Be referred to 21 above.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

Generally speaking, in Chile corporate governance is utilized to protect minority shareholders and the companies themselves but not to shield Directors and Officers.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

Not in the short term.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

The Chilean insurance contract provisions are mostly contained in the Code of Commerce, which was enacted in the year 1865 with no significant amendments up to now (the only except is marine insurance whose regime was totally completely revised and amended in 1988). In this respect, there are have been discussions at the legislative level to update the Code but it may take some time before a major change happens.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

No.

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England 1

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible Directors and Officers?

In the UK the concept of what constitutes a "director" is not clearly defined and s.250 Companies Act 2006 ("the Companies Act") simply states that the term director "includes any person occupying the position of director, by whatever name called". This reflects the fact that, in practice, the wide diversity of business conducted by companies means that the function of director can vary significantly from company to company.

The term "officer" is similarly wide and encompasses such individuals as the company secretary or any employee who is employed in some form of managerial capacity.

2. What are the duties/liabilities of Directors and Officers to the company?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

(a) Under common law directors and officers have a duty to act in the best interests of the company and to exercise the level of skill that might reasonably be expected of someone in his position and with his level of expertise. What constitutes a reasonable level of skill will be judged in the context of the standard test for negligence/breach of duty under English law.

(b) ss.171-177 of the Companies Act sets out the general duties of directors (including shadow directors). These general duties are derived from the common law duties and from certain equitable principles and can be summarised as follows:-

- A duty to act within the powers conferred by the company's constitution and for the purpose for which such powers were bestowed (s.171);
- A duty to act in a way which promotes the success of the company for the benefit of its members as a whole (s.172);
- A duty to exercise independent judgement (s.173);
- A duty to exercise reasonable care, skill and diligence (s.174);
- A duty to avoid conflicts of interest (s.175);
- A duty not to accept benefits from third parties conferred by virtue of his being a director or his doing (or not doing) anything in his capacity as director and where that benefit gives rise to a conflict of interest (s.176); and
- A duty to declare any interest (whether direct or indirect) in proposed transactions and arrangements (s.177).

(c) All companies incorporated in the UK and listed on the Main Market of the London Stock Exchange are required under the Listing Rules to report on how they have complied with the Combined Code on Corporate Governance ("the Combined Code") which sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. The Financial Reporting Council announced a review of the Combined Code in March 2009.

3. What are the duties/liabilities of Directors and Officers to the shareholders?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

(a)(b) Following the introduction of the Companies Act the common law duties/liabilities of directors and officers to a company's shareholders are dealt with under s.172 of the Companies Act. This provides that a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members (i.e. shareholders) as a whole taking into account:-

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

Failure by a director or officer to comply with s.172 of the Companies Act incurs a personal liability by the director/officer to the company's shareholders. Exactly how s.172 is to be interpreted is likely to come under increased scrutiny in the current financial climate given the number of companies in financial difficulties leading to questions to be asked about whether, for example, directors took prudent long term decisions.

Limitations and Exemptions

The duty imposed by s.172 of the Companies Act has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

4. What are the duties/liabilities of Directors and Officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

Directors and officers are generally not liable on contracts made between the company and third parties or for torts committed by the company on third parties. There are some exceptions, however, where directors and officers can incur personal liability to third parties for actions taken by them in their capacity as directors and officers. These include the following:-

Contract

- damages for fraudulent/negligent misrepresentations in the course of negotiating a contract between the company and third party;
- damages where the director guarantees the company's performance of contractual obligations and the company subsequently fails to perform;
- damages where the director enters into a contract on behalf of the company which exceeds his authority and the company avoids the contract.

Tort

- damages for negligent misstatements made on behalf of the company;
- damages for breach of duties in relation to the company's creditors in the event of insolvency;
- criminal liability under the Health and Safety at Work Act 1974 where the business of the company is conducted in such a way as to expose third parties to risks to their health and safety.

5. What are the duties/liabilities of Directors and Officers to the State (i.e. criminal or regulatory liability)?

(a) at Common Law;

(b) under Legislation; and

(c) under Regulations

Are there any Exemptions from or Limitations on Liability?

(a)(b) Directors and officers may face criminal proceedings in relation to such matters as:-

- consenting to or conniving with an offence committed under the Fraud Act 2006 (s.12 Fraud Act 2006);
- conspiracy to defraud (s.5 Criminal Justice Act 1993);
- breach of the Health and Safety at Work Act 1974 and accompanying regulations.

(c) The FSA Handbook Senior Management Arrangements sets out the responsibilities of directors and senior management in relation to regulated companies and includes such matters as risk control, record keeping, conflicts of interest and liquidity controls.

Limitations and Exemptions

The Corporate Manslaughter and Homicide Act 2007 provides that whilst a company can be convicted of corporate manslaughter or corporate homicide no individual liability will attach to its directors and officers.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a)(b) S.172 of the Companies Act (see paragraph 3 above) provides that one of the matters to be taken into account in promoting the success of the company is "the interests of the company's employees". However, the duties contained under ss.171-177 of the Companies Act are duties owed by directors to the company itself and not to particular individuals such that it is unlikely that an employee would be able to take direct action against a company's directors for breach of s.172.

Directors and officers will, however, owe common law duties of care to a company's employees in tort.

(c) Both companies and individual directors owe duties to the company's employees under the Health and Safety at Work Act 1974 and the accompanying regulations.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a)(b) Directors and officers owe a common law duty of care to act in the best interests of the creditors in the event of insolvency or pending insolvency as opposed to in the best interests of the company. This is given statutory weight under s.172(3) of the Companies Act which provides that a director's duty to promote the best interests of the company "*has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company*".

An example of such an enactment can be found in s.212 Insolvency Act 1986 which provides that the Court, upon the application of the official receiver

or liquidator, has the power to require a director who "*has misapplied or retained ... any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company"* during the course of the winding up of a company to *"repay, restore or account for the money or property or any part of it"* or to *"contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just*".

8. What remedies are available?

To the extent that directors and officers owe duties to the company under ss.171-177 of the Companies Act (see paragraph 2 above) then s.178 of the Companies Act provides that the remedies for breach of these duties "*are the same as would apply if the corresponding common law rule or equitable principle applied*". This will normally be restricted to an award of damages although, in certain instances, may give rise to an order for injunctive relief or restitution.

In relation to claims for breach of duty by shareholders, third parties, employees and trustees in bankruptcy the usual remedies will again be damages, injunctive relief or restitution although fines may be incurred in relation to breaches of health and safety legislation, FSA Regulations etc. Claims for breach of duties owed by directors to the State will almost certainly result in criminal fines.

9. Who has the right to claim?

Depending on the precise circumstances all of the various individuals and entities identified in paragraphs 2 - 8 above as being owed duties by directors will have the right to claim against directors in the event of a breach of such duties.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

S.233 of the Companies Act provides that, although provisions which exempt a Director from liability or which permit for a Company to indemnify a Director for liability are void (s.232), this "*does not prevent a company from purchasing and maintaining for a director of the company, or of an associated company, insurance against any such liability*".

As such, s.233 permits (although does not oblige) a company to purchase and maintain insurance for a director against any liability attaching to that director in connection with any negligence, default, breach of duty, or breach of trust in relation to the company of which he's a director.

11. Are there any corporate Procedural prerequisites to effecting cover?

In the UK it is generally accepted that the question of whether or not to purchase and maintain insurance for the directors and officers of a company is ultimately a question for the Board of Directors of that company. It is consequently open to companies to include procedural prerequisites in their Articles of Association regulating the circumstances in which directors are permitted to purchase insurance protection as they deem appropriate. As regards the Model Articles of Association for private and public companies set out in the Companies (Model Articles) Regulations 2008 these propose including in a company's Articles of Association the standard provision that the directors "*may decide to purchase and maintain insurance, at the expense of the company, for the benefit of any relevant director in respect of any relevant loss*".

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Insurance contracts in the UK are contracts of utmost good faith which impose an obligation upon a potential insured to give disclosure of certain facts to the insurer in advance of the policy becoming binding. In particular, the potential insured is required to give disclosure of all facts known to the insured which are material to the risk and which it is reasonable to assume that the insurer will want to take into account in determining whether or not to provide cover. If the insured fails to disclose a material fact and this failure influenced the insurer's decision to provide cover then the insurer will be entitled to avoid the policy.

Policies of D&O insurance issued in the UK often provide protection both to the individual directors ("Side A Cover") and to the company in the event that it is required to indemnify its directors ("Side B Cover"). As a result the "insured" under the policy will often be both the individual directors and the company. This triggers disclosure obligations on the part of both the company and its directors and officers and the directors and officers will be under an obligation not only to disclose any material fact to insurers but also to the company so as to enable the company to comply with its own disclosure obligations.

The existence of multiple insureds under D&O policies can often create difficulties as non-disclosure by one director can potentially render the policy voidable against all directors and against the company as a whole.

13. Are there any tax implications connected to the purchase of D&O cover?

The purchase of D&O insurance has a number of tax implications as follows:-

(a) Premiums are exempt from VAT although will attract Insurance Premium Tax at the standard rate of 5%.

(b) In the event that the premium is paid by the company then this will be deductible for corporation tax purposes. Payment of premium by the company is not a taxable benefit as regards the individual directors.

(c) In the event that the premium is paid by the individual directors this will attract tax relief under the Income Tax (Earnings and Pensions) Act 2003.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

There is currently no obligation on UK companies to purchase D&O insurance for the benefit of their directors. Prior to the implementation of the Companies Act in the UK the Company Law Reform Committee published the "Company Law Reform Bill - White Paper 2005" which considered the need for reform in relation to indemnifying company directors and concluded that there was a need to "*strike a careful balance*" between the need for the law to "*be firm and robust to deal fairly with cases where something has gone wrong*" and the need for the UK to have "*a diverse pool of high-quality individuals willing to assume the role of company director, and a willingness by directors to take informed and rational risks*". It was felt that this balance was achieved by permitting the purchase of D&O insurance (and by permitting companies to indemnify directors in certain circumstances) but that there was no necessity to make this purchase compulsory at the present time.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

By comparison to a lot of other jurisdictions the UK has a relatively well developed D&O market. Consequently it would be usual for UK companies to purchase D&O cover locally although cover may also be purchased in the European or North American markets.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

As set out at 12 above policies of D&O insurance issued in the UK provide both Side A Cover (cover for individual directors) and Side B Cover (cover in respect of a company's liability to indemnify its directors). Side A and Side B cover may extend to "employees" (or the company's liability to indemnify its employees) although this will usually only extend to "employees acting in a managerial or supervisory capacity". In addition cover is offered to companies in respect of that company's liability to third parties (usually shareholders) where concealment of information by the company has a detrimental impact on share price ("Side C cover"). Side A Cover, Side B Cover and Side C cover are not necessarily contained in the same policy and can be bought on a stand-alone basis.

17. What is commonly covered?

The principal purpose of D&O insurance in the UK is to provide indemnity for liabilities incurred by directors and officers as a result of their acting in the course of the business of the company. This will not ordinarily be limited simply to the amount of compensation that that director or officer is legally liable to pay but will also extend to the costs incurred by the director or officer in defending any claims against him.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

(a) It is one of the fundamental principles of insurance law that an insurance policy which provides cover for criminal acts will be contrary to public policy and consequently it will not be possible to recover under that policy for such acts. In the context of D&O insurance this means that the directors and officers of a company will not be able to recover under the policy to the extent that their conduct amounts to a criminal offence although cover may be available for the legal costs of defending any such claim subject to reimbursement of the insurer in the event of conviction. The range of potentially criminal acts for which cover will be commonly excluded include such matters as:

- failure to file accounts or annual returns;
- market abuse or misconduct (i.e. fraud);

In addition the Financial Services Authority in the UK prohibits the purchase of insurance cover in respect of the payment of FSA fines.

(b) As a matter of common practice insurers will specifically exclude those matters which they are not prepared to cover. These may be matters which are specific to the individual company and its directors and officers (e.g. issues of which the insured was aware prior to the commencement of cover) or may be matters of general concern to the insurance market (e.g. pollution). In particular D&O policies issued in the UK commonly exclude (i) cover for the negligent provision of advice by directors to third parties as part of the provision of professional services offered by the company; and (ii) loss to the company resulting from the wilful misconduct/fraud of a director carried out for personal gain.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Claims can be brought by the "insured" under the policy. In the case of Side A Cover this will be the individual directors and officers whilst, in the case of Side B Cover and Side C Cover, the insured will be the company itself. Who is the "insured" under any particular policy will depend on the definition of "insured" within the policy itself. This may extend to provide cover to a group of companies rather than just an individual company and may provide cover to retired directors in addition to current directors.

20. What is the procedure for bringing a claim?

Again this will depend on the precise wording of the policy itself. One particular issue to be aware of are that D&O policies in the UK are commonly written on a "claims made" basis which provides coverage for claims reported or made during the period of the policy regardless of the actual date of loss or other event giving rise to the notification. Another common feature is that D&O policies will usually contain

"claims control" or "claims cooperation" provisions requiring an insured who is defending a claim to consult with insurers as to the conduct of the defence or even hand over conduct of the defence to insurers entirely.

INDEMNIFICATION

21. Can the company indemnify its Directors and Officers? If so, for what?

S.232 of the Companies Act contains the general provision that:-

"*Any provision by which a company directly or indirectly provides an indemnity (to any extent) for a director of the company, or of an associated company, against any liability attaching to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company of which he is a director is void*".

This general provision is subject to a number of exceptions set out in ss.233-235 of the Companies Act. In broad terms these permit companies to indemnify directors in respect of their liabilities to third parties excluding criminal fines and regulatory penalties (s.234) and to indemnify directors of a company that is a trustee of an occupational pension scheme against liability incurred in connection with the company's activities as trustee of the scheme (s.235). S.233 relates to the purchasing of insurance in respect of a director's liabilities (in respect of which see paragraph 10 above).

22. How is the indemnification dealt with in practice?

UK companies will often indemnify their directors to the fullest extent permissible in law. Companies who provide such indemnities should take care when purchasing D&O cover that such cover does not contain any presumption of indemnity which could prohibit directors from recovering under the policy in circumstances where they are able to seek recovery from the company under the indemnity.

Any Other Business

23. To what extent is corporate governance utilised to shield Directors and Officers?

The Combined Code sets out standards of good practice which apply to all companies incorporated in the UK and listed on the Main Market of the London Stock Exchange (see paragraph 2(C) above for more information).

24. Are there any anticipated legislative/regulatory changes to the extent of Directors' and Officers' liabilities?

There are no anticipated UK legislative/regulatory changes proposed as to the legality of insurance cover/indemnification for directors and officers.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

There are a number of issues surrounding D&O insurance cover which directors in the UK need to be alert for. The following are a number of the key issues to watch out for although is by no means an exhaustive list:

(a) The policy should be a composite policy providing each director with a separate interest in the insurance which will not be affected by the misconduct of another director.

(b) The policy should be irrevocable by any party other than the insurer for non-payment of premium. This avoids situations where, for example, a policy is cancelled by administrators in order to maximise assets.

(c) D&O policies are commonly written on a "claims made" basis (see paragraph 20 above) and care should be taken to ensure that claims are notified during the correct policy period.

(d) A director who resigns or retires is vulnerable for a period of at least six years, during which claims may be made against them for wrongful acts that occurred prior to their departure. If the policy continues in force or is renewed or replaced, then such claims would usually be covered because cover is predicated on a claims-made basis. If the policy is not renewed, the director faces a period of uncertainty and will not be covered for claims made after such non-renewal.

(e) Both companies and their directors should be alert for any form of "presumptive indemnification" clause contained in the policy (see paragraph 22 above).

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

S.250 Companies Act 2006 (" the Companies Act") provides that "..' director' includes any person occupying the position of director, by whatever name called." It is his function, rather than title, therefore, that determines whether a particular person is a responsible director (or officer).

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a) Directors owe common law duties to exercise skill, care and diligence, governed by the general law of negligence. Various duties also derive from the director's fiduciary relationship with the company.

(b) Ss.171-177 of the Companies Act set out the general duties which directors owe to companies. These are derived from the common law and are to be interpreted and applied in the same way. They are:

(i) to act within their powers (s.171);

(ii) to promote the success of the company (s.172);

(iii) to exercise independent judgement (s.173);

(iv) to exercise reasonable care, skill and diligence (s.174);

(v) to avoid conflicts of interest (s. 175);

(vi) not to accept benefits from third parties (s.176); and

(vii) to declare any interest in proposed transactions and arrangements (s.177).

Directors and officers may owe further duties arising from their company's Articles of Association and may be liable for acts not permitted by the objects clause in the Memorandum of Association.

(c) The level of regulation to which a company is subject depends on whether it is a private limited company or a public company and whether its securities are traded on an exchange. For example, a company whose shares are traded on the Main Market of the London Stock Exchange ("the Main Market") will be subject to considerably more regulations, including the provisions of the Combined Code on Corporate Governance ("the Combined Code"), which sets out the rules for the best practice of corporate governance.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a) Prior to the coming into force of the Companies Act there was a fiduciary duty at common law duty to act in good faith in the best interests of the company. This duty has now been codified – see (b) below.

(b) S.172(1)(b) of the Companies Act introduces a requirement that directors act in a way to promote the success of the company for the benefit of the company's members, i.e. its shareholders, as a whole. In so doing, the director must have regard (among other matters) to the likely consequences of any decision in the long term, the need to foster the company's business relationships and the need to act fairly as between the members of the company. A derivative action may be brought by the shareholders in the name of the company in respect of any 'wrongdoing' – see 9 below.

(c) As mentioned in 2(c) above, public companies, in particular companies whose securities are traded on an exchange such as the Main Market, are subject to greater regulation than private companies. The FSA regulates most financial services markets, exchanges and firms, setting standards and, if necessary, taking action. Directors and officers of a company trading on such an exchange are potentially personally liable for false or misleading information or omissions of material information in admission and offer documentation relating to securities. Criminal penalties may ensue, as well as civil liability to pay compensation to affected investors.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a) Since companies are legal entities separate in law from those who establish them, and directors are simply the persons empowered to represent the company in its dealings with third parties and to manage the company's affairs, when directors act on behalf of a company it is usually the company which in law is regarded as having entered into any contract with the third party and which is

responsible in tort for any wrongdoing on the part of its directors. However, a director will be liable to third parties in negligence for his own default. A director of a company whose securities are publicly traded may also be liable for negligent misstatements or deceit in its offer documentation.

If the company is liable for actions authorised or committed by a director, it may be entitled to make a claim for contribution against the director in question (both under common law and statute). If the negligent act is sanctioned by the board, co-directors could in theory also be liable in the same way.

(b) Under s.172(1) Companies Act, directors should have regard to a number of factors when carrying out their duty to promote the success of the company. These factors include the suppliers, customers and 'others'. The provisions of the Companies Act, also contain administrative obligations, such as filings. Both the company and the defaulting directors and officers will be liable for any breach of these duties. Directors of companies in financial difficulties could also face claims from a liquidator under the Insolvency Act 1986 for offences such as Fraudulent Trading and Wrongful Trading.

(c) Directors of FSA regulated companies should adhere to the relevant regulations and are liable to censorship and fines. For example, a person should not unless they have adhered to s.21 of the Financial Services and Markets Act 2000 ("FSMA") enter into a financial promotion. Breach of section 21 of the FSMA has both criminal and civil consequences. Directors and officers could also be liable to investors dealing in the company's securities who are encouraged to invest by false/misleading information (s.397 FSMA). Directors should be aware of further liabilities under FSMA, including market abuse which carries an unlimited fine. Directors of listed companies also need to consider guidelines put in place by Investment Protection Committees ("IPCs") such as the Association of British Insurers.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As well as the statutory obligations contained in the Companies Act, directors and officers face a number of other potential liabilities set out in common law, legislation and regulations. Under common law, directors can be liable for deceit, negligent misstatement and fraudulent misrepresentations. Directors and officers face both civil and criminal liability from breaches of the Insolvency Act 1986 and FSMA. In addition, directors and officers will also be liable for offences such as theft (s.19 Theft Act 1968), fraud (Fraud Act 2006) and insider dealing (Criminal Justice Act 1993). Directors may also be disqualified from acting as such for misconduct under the Company Directors Disqualification Act 1986.

The type of company the person is a director of will determine the amount of regulations that they will be subject to. A director of a listed company will be far more heavily regulated than a director of a private limited company. The regulations that a director of a listed company may need to consider are: the rules and guidance contained in the FSA Handbook (including the Listing Rules, Transparency Rules and Disclosure Rules); the IPC guidelines, the Combined Code; the Model Code and the City Code on Takeovers and Mergers Takeover Code. Directors will also need to consider health and safety regulations, environmental legislation, competition law and their potential liabilities under corporate manslaughter.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a) In certain circumstances directors have been found to owe their employees a fiduciary duty at common law.

(b) Under s.172(1)(b)(c) Companies Act, directors have a duty to take into consideration the interests of employees. However, the section is widely regarded as being of little significance since the duty is owed to the company. Any failure to adhere to its terms is incapable of giving rise to personal liability on the part of the directors since employees lack locus standi to enforce it.

(c) Companies owe their employees duties under various health and safety regulations. When the regulations are breached, and a director contributed to the breach through consent, connivance or neglect, s/he can be held criminally liable.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(a) Where a company is insolvent or on the verge of insolvency, the directors owe a common law duty to act in the best interests of the creditors of the company.

(b) Under s.172(1)(c) Companies Act, while the company remains in existence and solvent, it owes duties to creditors. Where the company is in danger of insolvency, the directors may potentially owe additional duties in order to preserve the assets of the company and to preserve intact its creditors' interests. In addition, various offences created by the Insolvency Act 1986, the Criminal Justice Act 1993 and the Company Directors Disqualification Act 1986 are designed to protect the assets of the company and persons dealing with the company.

(c) Listed companies are subject to additional regulation under the Listing, Prospectus, Disclosure and Transparency Rules, for example in relation to misleading the market.

8. What remedies are available?

Under s.178 Companies Act, the consequences of a breach of a director's/officer's duties are the same as for breach of the corresponding common law or equitable principles. The remedy for a breach of the duty of care, skill and diligence is usually an award of damages. Remedies for breaches of other duties include damages, an injunction, the setting aside of the transaction, restitution, account of profits and the restoration of company property held by the director.

9. Who has the right to claim?

Duties under the Companies Act are owed to the company and in most circumstances only the company will be able to enforce them. However, in very limited circumstances shareholders are able to sue directors, in the company's name, and to recover on the company's behalf loss suffered as a result of a director's negligence, default, breach of duty or breach of trust. This is known as a derivative action. In very narrow circumstances shareholders will also be able to claim, in the company's name, against third parties implicated in any breach where the damage suffered by the company arose from an act involving a breach of duty on the part of the director (for example, for knowing receipt of money or property transferred in breach of trust of for knowing assistance in a breach of trust). Creditors may also be able to claim against directors for wrongful or fraudulent trading under the Insolvency Act 1986. In addition, investors (including subsequent investors) who acquire securities in a company based on false or misleading information may be able to get compensation for any loss.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

S.233 Companies Act permits a company to purchase insurance for its directors, and those of an associated company, against any liability attaching to them in connection with any negligence, default, breach of duty or breach of trust by them in relation to the company of which they are a director.

11. Are there any corporate procedural prerequisites to effecting cover?

This will depend upon the terms of the individual policy.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

(a) There are many circumstances in which directors and officers are required to disclose information to their shareholders (both before and after commencement of insurance cover). For example, listed companies are required to publish financial reports and details of changes to their share capital and to inform the market as soon as possible wherever there is an event that, if known, would be likely to have a substantial effect on the company's share price.

(b) Under English law, an insurance contract is a contract of utmost good faith. This obliges a potential insured to give pre-contractual disclosure of all facts known to him which are material to the risk and which a prudent insurer would want to take into account in determining whether to provide cover and/or the appropriate level of premium and/or the appropriate terms and conditions of cover.

13. Are there any tax implications connected to the purchase of D&O cover?

The premium for the purchase of D&O insurance is not classified as a taxable benefit when paid by the company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

There is no legal requirement in the UK for any type of company to purchase D&O cover.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance is often purchased locally but is also purchased from overseas markets. There is a longstanding practice of reinsuring D&O policies in the London market.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

There are three categories of beneficiary:

(i) Individual directors and officers;

(ii) The company itself; and

(iii) The company's shareholders.

17. What is commonly covered?

D&O liability insurance commonly deals with the following main areas of cover:

(i) The director's/officer's own liability to third parties as a result of a breach of contractual or fiduciary duties or actions amounting to a tort;

(ii) Reimbursement of the company in respect of any indemnity paid in advance to its directors;

(iii) Defence costs which the director himself or the company may incur as a result of legal proceedings arising from the above; and

(iv) Shareholders' costs and expenses incurred in pursuing claims against individual directors and/or officers.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

(a) Because the purchase of cover is prohibited; or

(b) As a matter of common practice?

(A) See 10 above.

(B) One or more of the following are commonly excluded from D&O cover (on the basis of public policy considerations and/or as a matter of market practice):

(i) the rendering of, or failure to render, professional services and/or professional advice;

(ii) liability for loss of property which the director or officer has misappropriated;

(iii) loss by reason of a director's fraud or misconduct;

(iv) illegal profits and a director's subsequent accountability in respect thereof;

(v) where an activity prohibited by statute is carried out;

(vi) liabilities arising under contract alone;

(vii) claims arising from one insured alleging wrongful acts or misconduct by another insured; and

(viii) liability in regard to any employment claim brought by an insured person.

Insurers may also require exclusions in respect of acts occurring before the inception of the policy and pollution hazards.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Claims can only be brought by the policyholder, commonly the individual directors and officers, and/or the company.

20. What is the procedure for bringing a claim?

The policy will usually stipulate the claims procedure. D&O policies often contain notification clauses, whereby an insured must inform its insurer of a claim, or circumstances which may give rise to a claim, alternatively which is likely to give rise to a claim, within a specified period. Failure to do so may entitle the insurer to refuse to meet the claim.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Under s.232 Companies Act, companies in England are prohibited from indemnifying their directors from liability which would ordinarily attach to directors, save as specifically provided for in ss.233-235 of the Act. Ss. 233-235 Companies Act permit companies to indemnify their directors in respect of their liabilities for third parties (with the exception of criminal fines and regulatory penalties) and to indemnify directors of a company that is a trustee of an occupational pension scheme against liability incurred in connection with the company's activities as trustee of the scheme.

22. How is the indemnification dealt with in practice?

Companies will often indemnify their directors and officers to the fullest extent permissible in law.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

The Combined Code sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. All companies incorporated in the UK and listed on the Main Market of the London Stock Exchange are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

New legislation was introduced relatively recently in the form of the Companies Act and no other legislative/regulatory changes are anticipated in the near future, except that the effectiveness of the Combined Code is currently the subject of an on-going review.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

Not to the best of our knowledge.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

From the point of view of the insured, failure to notify a claim within proper time and/or to provide sufficient detail can prove fatal to its chances of recovery. It is important to set up and maintain proper lines of internal communication to ensure early identification of any errors or problems which may require notification, to make the notification sufficiently broad to cover all potential claims regarded as real risks, to review and update the notification before renewal and to make sure that notification is given to all

necessary parties, including excess layer insurers where relevant.

It is standard for coverage to be provided for defence costs if the claim would be covered if it were successful. There may be a number of separate allegations in a claim, some of which (such as negligence, breach of fiduciary duty and failure to conduct proper due diligence) might be covered under the relevant D&O policy, where some (such as fraud, unjust enrichment and claims for equitable relief) would not. All the allegations have to be defended, yet the defence costs are only recoverable in respect of certain of them. This often gives rise to disputes about the allocation of defence costs.

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France

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Responsible Directors and Officers are individuals or legal entities managing the company or having direction activities in the company and which are duly appointed in compliance with the requirements of the French Commercial Code.

The concept of non-executive director does not exist under French law. French companies may create study committees whose members are appointed by the board of directors and the activities of which are ultimately of the responsibility of the board of directors (article R.225-29 of French Commercial Code).

Under French law, the liability that applies to duly appointed Directors and Officers also applies to shadow directors which are commonly defined by case law as any person independently, regularly and effectively carrying out management and direction activities in the company. The status of shadow director is not automatic and must be proven.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

(i) Civil liability

Directors and Officers and shadow directors may be held jointly or individually liable towards the company, depending on the circumstances, for acts of mismanagement as defined by case law, for breaches of the company's articles of association, for infringement of laws and regulations applicable to the company. The civil liability of duly appointed Directors and Officers is based on the French Commercial Code, whereas, absent explicit reference in the provisions of the French commercial Code to shadow directors, French courts apply common law principles of tort liability provided for under the French Civil Code to found the civil liability of shadow directors.

Directors and Officers may be exempted from certain liabilities if a delegation of powers has been granted to one or more person being employees of the company.

(ii) Criminal liability

Directors and Officers, and, depending on the offence, shadow directors, may incur criminal liability for offences listed in the French Commercial Code, such as abuse of the company's assets or credit, or offences to company's law. It has to be noted that historically the French legislator considered criminal liability to be the most appropriate instrument to ensure lawful conduct of directors and officers. The "penalisation" of Directors and Officers has been largely criticised by French commentators and in the last few years a trend of depenalisation of business law can be noted.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The duties and liabilities of Directors and Officers towards shareholders are the same as those set out above in reply to question 2 towards the company.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Pursuant to well established case law, Directors and Officers (articles L.223-22 and L.225-251 of the French Commercial Code), and shadow directors (article 1382 of French Civil Code), may only incur civil liability towards third parties if they committed a fault that can be separated from their functions (faute détachable des fonctions) and is attributable to them. A fault is considered to be separable from the functions of a Director and Officer if such fault is intentional and of serious gravity and incompatible with the normal course of performance of their functions.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors, Officers and shadow directors may in particular incur tax liability in cases of serious and repeated non-compliance with tax law that would have made the collection of taxes and penalties impossible (article L.267 of French Tax Procedural Book), hidden distributions (article 1759 and 1754-V-3 of French Tax Code), or fraud (articles 1741 to 1745 of French Tax Code).

Furthermore, Directors and Officers and shadow directors may incur liabilities under specific French laws (e.g. social security laws).

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and Officers may incur criminal liability for "délit d'entrave" (interference in connection with the information and consultation process of a company's works council) under the French Labour Code (articles L.2328-1, L.2431-1, L.2432-1 and L.2433-1). They may also incur criminal liability for non compliance with hygiene and security regulations provided for under the French Labour Code.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors, Officers and shadow directors may incur liability where as a result of their mismanagement the liabilities exceed the assets of the company (article L.651-2 of French Commercial Code), personal disqualification (article L.653-1 of French Commercial Code) and criminal bankruptcy (article L.654-1 of French Commercial Code).

8. What remedies are available?

(i) Civil liability: award of damages.

(ii) Criminal liability: usually fine and/or imprisonment.

(iii) Other possible remedies: prohibition from managing a company, from controlling a company directly or indirectly etc.

9. Who has the right to claim?

Companies, shareholders, third parties, French tax authorities, employees, liquidators.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Yes. There are no provisions under French law prohibiting the purchase of D&O insurance cover.

The French Insurance Code does not contain specific provisions relating to D&O insurance. D&O insurance is therefore subject to the general rules of the French Insurance Code relating to liability insurance and in particular to articles L.124-1, L.124-2, L.124-3 and L.114-1.

Under French law D&O insurance qualifies as insurance on behalf of whom it may concern (assurance pour compte) which allows covering in a single policy document the insured interest of the policyholder and/or the insured on behalf of whom it may concern. In practice therefore, it is the company that enters into the insurance contract which benefits both the company as policyholder and insured and the known or contingent insureds referred to in the policy (e.g. Directors and Officers of the company or subsidiaries of the company, shadow directors, spouses, heirs, legatees, assigns or legal representatives of Directors and Officers etc.).

Any company, regardless of its company form, may purchase D&O insurance cover. However, given the costs associated with such insurance it appears that only large and medium size companies are seeking D&O insurance cover.

11. Are there any corporate procedural prerequisites to effecting cover?

No, from a legal point of view there are no corporate procedural prerequisites. In particular, the entering into a D&O insurance by a company does not fall within the scope of application of the French rules applicable to regulated agreements (conventions réglementées) requiring the prior approval by the board of directors and the approval by the shareholders at the general annual meeting following the conclusion of the D&O insurance contract. An agreement qualifies as regulated agreement if it has been entered into between the company and its directors and/or one of its shareholders, or between the company and another company which has directors and/or shareholders in common with it.

However, even though the D&O insurance contract is not entered into between the company and its director, it indirectly benefits Directors and Officers. Therefore, as a matter of caution, most insurers offering D&O in France require evidence that the entering into D&O insurance by Directors and Officers on behalf of the company has been approved by the board of directors.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Pursuant to the French Insurance Code (Article L. 113-2 of the FIC) any potential insured must, prior to the entering into an insurance contract, truthfully answer questions put by the insurer (generally on a written form basis by means of a questionnaire) that enable the insurer to assess the risks that it covers.

The precise scope of such questionnaire is left to the discretion of each insurance company. However, in relation to D&O insurance cover, the policyholder is generally required to provide corporate details of the company, such as company form, share capital, shareholders, corporate purpose of the company and geographical scope of the activity of the company in order to highlight potential risks Directors and Officers may face in foreign jurisdictions where the company carries on business.

13. Are there any tax implications connected to the purchase of D&O cover?

(i) The insurance premiums paid by the company to cover the liabilities of the D&O are deductible for corporate income tax purposes (article 39-1-1° of French Tax Code).

(ii) Furthermore, in accordance with Article 62 of the French Tax Code, the purchase of D&O cover by the companies is considered to be a taxable benefit for the Directors and Officers covered by the D&O insurance (Ministerial answer n°23071, p.1311, dated 11 July 1985 and MOA comity decision dated 15 March 2001).

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No, D&O cover is not a compulsory insurance.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

Historically the first insurers offering D&O coverage in France were French subsidiaries of US insurers (such as ACE Europe France, AETNA France, AIG Europe, CHUBB Insurance Company of Europe SA) where D&O coverage has been much more common than in France. Since 1980 more and more insurance undertakings (both EU insurance undertakings acting on a freedom of services or right of establishment basis and French insurers (such as AXA) offer D&O insurance. However, the D&O insurance market in France remains limited and the premium income of all D&O insurance contracts entered into by French companies has been estimated in 2007 to range between €60-€80M in total.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

In France the insured covered under a D&O policy are generally the Directors and Officers, the shadow directors, the voluntary liquidator of the company and of all the subsidiaries of the latter, but may also include spouses, heirs, legatees, assigns or legal representatives of the Directors and Officers where these individuals could be prosecuted for the liability of the insured party, especially in the case of death or incapacity of the latter.

17. What is commonly covered?

The purpose of D&O insurance in France is, in broad terms, to provide financial protection for Directors and Officers, or the company itself, against any indemnity for liabilities incurred as a result of claims brought against them on the grounds of civil liability for an offense committed in the course of the performance of the professional duties of a Director and Officer.

In addition, D&O insurance in most case will extend to the legal and certain other costs incurred by the insured individual in defending claims.

18. What is commonly excluded:

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

As a general principle under French insurance law all risks can be insured subject to contractual provisions of the policies. However, certain clauses of insurance policies will be regarded as null and void if they cover certain risks, as follows:

(i) loss and damage caused by the deliberate intent or fraud of the insured party;

(ii) loss and damage resulting from a decision of a criminal court, an administrative authority (e.g. tax, social security authorities) or a regulatory body.

In addition, the following is commonly excluded from D&O insurance coverage:

(iii) claims to obtain compensation for personal injury or equipment and any damage resulting from an injury,

(iv) claims which prior to the date of subscription of the contract, the policyholder was aware of.

(v) claims based on research by the insured or with its complicity of a benefit, compensation or personal advantage for which he had no legal right.

Although not strictly related to exclusions under D&O insurance, it has to be noted that it is current practice in France that the D&O policies contain limitations in relation to the indemnities. The limitation can either consist in a threshold – per claim or per annum – ("plafond de garantie") in excess of which the insurer will not be liable to make payments or in a deductible ("franchise") fixing a lump sum which has in any case to be borne by the policyholder and/or the beneficiary of the insurance policy. Provided that the policy does not state otherwise, both the plafond de garantie and the franchise are applicable regardless of the identity of the individual/legal entity bringing the claim against the director(s).

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

As set out in reply to question 10 above D&O insurance qualifies as insurance for and on behalf of whom it may concern (assurance pour compte) benefitting not only the company as policyholder and insured but also the known or contingent insureds referred to in the policy (e.g. Directors and Officers).

Claims under D&O insurance can not only be brought by the policyholder (i.e. the company) but also by each insured referred to in the insurance contract in the same way as if an individual contract had been concluded with the individual insured.

20. What is the procedure for bringing a claim?

D&O policies written in France commonly provide that the guarantee will cover claims submitted during the validity period of the contract, but may relate to acts committed before the effective date thereof. Most contracts also provide for a subsequent guarantee covering the insured against claims made during a period of 36 months from the date of contract termination provided that the claim relates to facts committed by an insured prior to that date.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

As set out in reply to question 2 to 4 above, directors and officers may be liable towards the company in particular for acts for infringement of laws and regulations applicable to the company or mismanagement as defined by case law and for breaches of the company's articles of association.

Where the company suffers a loss resulting from the misconduct of a director covered by the D&O insurance, the insurer will directly pay the indemnity to the company (policyholder and insured). There is no reason for the company to indemnify the directors and if the company would do so, such indemnification would constitute a misappropriation of company funds.

Towards third parties, it is the company that is held liable for the misconduct of the director unless the fault committed by the director qualifies as a fault that can be separated from its functions (faute détachable des fonctions) in which case only the director can be held liable.

According to article L. 124-3 of the French Insurance Code, the insurer is prevented from paying the indemnity to anyone else than the harmed third party unless such party has directly been indemnified by the person whose liability is engaged.

In other words, the insurer will directly indemnify the third party and it is only in the event that the person responsible (i.e. the company or if the director has committed a fault separate from its functions, the director itself) has already indemnified the third party that the insurer will pay/reimburse the indemnity to the person responsible.

Again there is no reason for the company to indemnify the directors (even in case no D&O insurance covering the directors' liability has been put in place) and if the company would do so, such indemnification would constitute a misappropriation of company funds.

22. How is the indemnification dealt with in practice?

As set out in reply to question 22 above, indemnification is made by the insurer either (i) by payment of damages directly to the claimant or (ii) by reimbursement of sums that the person responsible has paid to the claimant.

Similarly, if no D&O insurance covering the directors' liability has been put in place, and unless the director has not committed a fault separate from its functions, it is the company that pays damages caused by misconduct of the director directly to the claimant.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

The principal sources of corporate governance standards in France are the French Commercial Code and the French Financial and Monetary Code (as amended in July 2008 by law n° 2008-649 implementing Directive 2006/46/EC on corporate governance of listed companies), as well as a number of general recommendations and guidelines on corporate governance, most notably the corporate governance code that has been drawn up by the employers' associations AFEP-MEDEF.

The Financial Markets Authority (AMF) considers the employers' associations' (MEDEF/AFEP) code of "best practice" as a standard for the French capital market. As a matter of fact, it appears that the majority of listed companies refer to the above mentioned governance code.

Companies have discretion in adopting corporate governance codes, but in spite of a lack of any legal requirement, there is strong informal pressure in favour of voluntary compliance on a "comply or explain" basis.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

In 2007 the French government has put in place a working group (composed of lawyers, judges, university professors and representatives of French companies) in order for this working group to propose legislative changes aiming at the depenalisation of business law. However, the current economic context not being favourable to the depenalisation of business law and the public opinion obviously not supporting such measures, the project has been put on hold.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

No, there are no particular horror stories we can think of in relation to D&O insurance and indemnification products.

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Germany

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Form and nature of liabilities to which corporate representatives are exposed

In Germany, directors who are the appointed representatives of companies and members of the supervisory board of companies which have a compulsory supervisory board, such as stock corporations (Aktiengesellschaften) and other companies falling under the ambit of § 1, para. 1 Co-determination Act, automatically qualify as directors and officers of a company. The same applies to members of a supervisory board which has been voluntarily established by a company. Members of bodies such as an advisory board (Beirat), whose rights and duties are not defined by legal regulations but rather by privately set articles of association, are not considered to be officers of a company.

The duties and liabilities of the directors and officers of German companies are de-fined in the legal Acts specific to each type of company, i.e. § 93 Stock Corporation Act for stock corporations and § 44, paras. 2 and 3 GmbH Act for the most popular companies with limited liability. The duty to manage the company with reasonable care, skill and diligence and to further the business of the company is, however, common to all corporate legal entities. The aforementioned legal Acts and a host of other legal Acts contain additional duties; the duties of directors and officers of regulated industries, such as the insurance industry, may serve as a example for increased duties. Stock corporations quoted on the stock exchange are subject to the German Corporate Governance Kodex; the provisions of the Kodex may, however, also serve to interpret the general duties of directors of other types of companies where the duties are only defined in a very broad manner. In addition thereto, duties of directors may be specified in the service agreements signed between the company and those directors.

German law does not specifically differentiate between the duties of directors and officers towards shareholders and other third parties. Only in very exceptional cases does the law grant the right of direct action to shareholders against directors and officers, see for instance § 31, para. 6 GmbHG or §117 Aktiengesetz-AkG. Otherwise directors expose themselves and their company to liability whenever they infringe the rights of third parties when acting in the interests of the company. There is no legal limitation of this liability in place.

Directors and officers are liable to the State for criminal or regulatory offences just like any other citizen, and a kind of liability for a criminal act cannot be imposed on a corporate entity unless a representative of the entity is at the same time found guilty of having committed a criminal act. Companies may, however, be fined in connection with regulatory offences committed by a representative of the same. One very drastic example of such consequences is the right to impose drastic regulatory penalties under EU Cartel Law. There are numerous specific duties imposed on directors of companies under general commercial law (e.g. pertaining to keeping the books in an orderly fashion) and under other legal acts (e.g. on communicating true and correct information to shareholders and the public), under cartel and insolvency laws and more specifically under laws and regulations pertaining to regulated industries. A violation of many of these duties can only be committed by directors, and a violation of the more significant duties triggers criminal sanctions. Recent legal re-visions and the jurisdiction have increased the scope of the duties of directors and officers of companies in as much as it has been clarified that they have to organise the responsibilities within the company in such a manner that non-compliance with laws and regulations will be prevented to the largest extent possible. All of these du-ties and liabilities may not be limited by contract or otherwise.

Employees sign their employment contract with the company and if they believe that their rights have been disregarded, they have to address their complaint to the company and not to one of its directors, unless it involves an exceptional case in which a director has acted maliciously to the detriment of a specific employee. If a director and officer should be found liable of having caused bodily injuries to an employee by act or omission, the injured employee could only request to be indemnified by the director or officer responsible, if the same is found to have acted in a wilful manner. In all cases of negligent conduct, the employees will be protected under compulsory insurance which companies and all enterprises have to take out with semi-state agencies (Berufsgenossenschaften) connected with a full release of the directors or officers.

If a German company should become over-indebted or unable to honour its financial liabilities in a timely manner, its directors are obliged to apply for the opening of insolvency proceedings without undue delay but in no event later than three weeks after having become aware of such situation. Failing to comply with this duty will result in the directors being prosecuted for having committed a serious criminal act and being personally liable for any loss incurred by third parties/creditors or the company as a result of such delays. Once the directors have realised that the situation is precarious, they have to stop all payments to third parties, which includes their duty to withdraw any and all automatic debiting approvals and to make arrangements for payments to the company to no longer be made to bank accounts with a negative balance. Once the petition has been filed, a court will immediately appoint a preliminary insolvency administrator who will take over the management of the company completely and/or without whose prior approval the directors may no longer act on behalf of the company. The directors have to comply with this restriction on their representation, but are otherwise not subject to any particular du-ties towards the bankruptcy administrator. Their liability towards the company will change into a liability towards the insolvency estate once the insolvency proceedings have been finally opened, but in many cases the insolvency administrator will renounce the services of the former directors.

A director who has failed to comply with his duties and has committed an illegitimate-mate act or omission will be liable to the injured party for the damages thus caused under civil law, and if such act or omission is qualified as a criminal offence, he may be subject to a fine in cases of lesser gravity and to imprisonment if more serious violations have been committed. The violation of competition or corruption laws may, in addition thereto, entitle the authorities to skim off the profit of the company achieved by such

manoeuvres. As a rule, the company itself has to pursue claims for damages against directors who fail to comply with their duties. The courts have decided that the supervisory board of a stock corporation does not have the right to waive a potential claim against a managing director. Only in very exceptional cases will the shareholders have the right to file a kind of derivative suit against the company pursuant to § 148, para. 1 Stock Corporation Act. The share-holder derivative suit has thus far not seen much light in Germany yet. The insolvency administrator is always entitled to raise claims on behalf of the company against the then former members of the board of directors or supervisory board. Employees and other third parties may raise claims if their protected interests should be detrimentally impacted by a director, unless an exception applies. If an act or omission committed by a director qualifies simultaneously as a criminal of-fence, such aspect can only be pursued by the competent State attorney and such of-fence may trigger a fine or imprisonment or both, depending on the gravity of the offence.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

Despite the company being the policyholder, claims can, as a rule, be brought only by the directors and officers who are covered. Previously, directors and officers were not allowed under the policy terms to assign their indemnification claim to the company if the company suffered damage as a result of their wrongdoing. However, the interdiction to assign this is no longer permissible under the new Insurance Contract Act so that now companies having suffered a damage might have a direct claim against the insurer subject to prior assignment. The policy terms require that the policyholder and the insureds notify the insurer without undue delay of any claim which has been raised against them by a third party. Failure to comply with such duty does, however, not automatically entitle the insurer to refuse to meet the claim; this entitlement will only arise if and to the extent that the insured or policyholder, in a wilful manner, did not comply with his duty to notify and if the policy terms so provide. If the failure was committed in a negligent manner, the insurer's duty to indemnify may be reduced in accordance with the level of negligence. The insurer is not entitled to refuse the claim if the failure to inform is not causal for the assessment of the insured event or does not impair the adjustment of the loss or damage.

D&O policies issued in Germany provide direct protection to the directors and officers and indirectly also grant protection to the company; if a breach of duty has resulted in an event of damage for the company, the cover extends to the amount of the claim, if justified, and also to the legal costs up to the insured sum. The cover-age for the payment of administrative penalties or even criminal fines is not permit-ted and might even qualify as an offence under certain circumstances.

Despite the company being the policyholder, claims can, as a rule, be brought only by the directors and officers who are covered. Previously, directors and officers were not allowed under the policy terms to assign their indemnification claim to the company if the company suffered damage as a result of their wrongdoing. However, the interdiction to assign this is no longer permissible under the new Insurance Contract Act so that now companies having suffered a damage might have a direct claim against the insurer subject to prior assignment. The policy terms require that the policyholder and the insureds notify the insurer without undue delay of any claim which has been raised against them by a third party. Failure to comply with such duty does, however, not automatically entitle the insurer to refuse to meet the claim; this entitlement will only arise if and to the extent that the insured or policyholder, in a wilful manner, did not comply with his duty to notify and if the policy terms so provide. If the failure was committed in a negligent manner, the insurer's duty to indemnify may be reduced in accordance with the level of negligence. The insurer is not entitled to refuse the claim if the failure to inform is not causal for the assessment of the insured event or does not impair the adjustment of the loss or damage.

INDEMNIFICATION

A company is liable towards third parties if one of its directors has violated his du-ties towards a third party. In such event, it is the company, in particular if it is one whose shares are traded in a regulated market, which has the duty to take recourse against such director, unless the shareholders unanimously decide otherwise. It is unusual for German companies to undertake to hold a director harmless if a dam-aged third party chooses to hold the director rather than the company liable for wrongdoing. It would be considered to be an abuse and therefore invalid if a company were to promise to indemnify a director for criminal fines or regulatory penal-ties. In practice, it is frequently a very complex matter to draw a line between the effects of a business judgment which (with hindsight) in the end turns out to be a misjudgement and consequences caused by a lack of business diligence. In cases where doubt remains, companies will decide in favour of the director and assume the liability without subsequently turning to the director for indemnification. The rules of corporate governance, and more so the requirements under corporate compliance, have triggered the level of tolerance towards mismanagement and other wrongdoings of directors and officers having significantly decreased in the public eye. In the long term this may have an impact on courts and their findings with respect to the level of care and diligence to be expected from directors and officers. In the short term this has just provoked the Legislator to introduce legal changes (which have been passed by Parliament on June 18, 2009) imposing new duties on directors and officers, including members of the supervisory board. The supervisory board will now have to see to it that the remuneration paid to executive directors will be reasonable and that a variable part of the remuneration will be based on the long-term success of the company. If the company should get into stormy waters, the supervisory board might have to adjust the remuneration downwards in order to stop it becoming unreasonable. The members of the supervisory board will have to jointly and severally indemnify the company if a court subsequently finds that the amount of remuneration has been excessive and thus unreasonable. The new legal provisions indirectly sanction the taking out of D&O cover, but impose a duty on the afore-mentioned companies to arrange with the insurer for a self-retention to the detriment

of the director and officer of a minimum of 10 per cent of the damage up to a minimum of 150 per cent of the same's annual fixed remuneration.

All in all, one may observe for Germany that the legal framework setting out the parameters for the liabilities of directors and officers has not changed significantly over the last 10 years, but that the willingness of companies and entitled third par-ties to claim damages from directors and officers whenever there is the slightest suspicion of mismanagement or wrongdoing has increased dramatically in that period. Despite that, the level of premium charged for D&O policies has remained relatively stable but it may well be that this will have to change in the years to come.

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Hong Kong

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

- A "director" is widely defined. In various sections of the Companies Ordinance, Cap 32, this term includes shadow directors, alternate directors, managing directors, executive directors, chief executive officers, and non-executive directors.
- Under section 2 of the Companies Ordinance, "director" includes any person occupying the position of director by whatever name called, and "officer" includes a director, manager or secretary. A "shadow director" is defined as a person in accordance with whose directions or instructions the directors or a majority of the directors of the company are accustomed to act.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- There is no statutory general statement of directors' duties/liabilities in Hong Kong. The common law position is followed. The duties are summarised in a set of non-statutory "Guide on Directors' Duties" issued by the Companies Registry in April 2006 including:-
- to act in good faith and for the benefit of the company
- to use powers for a proper purpose
- not to delegate powers except with authorization
- to exercise due care and skill
- to avoid conflict of interests with the company
- not to enter into transactions in which the director has interest except in compliance with the law
- not to gain advantage from use of position
- not to make unauthorised use of company property or information
- not to accept benefit because of position
- to observe the company's memorandum and articles of association
- to keep proper books of account
- Directors and officers of a company may be liable to the company for any loss or damage suffered by the company caused by their improper management of the company's property, their negligence or breach of fiduciary duty.
- As regards statutory duties/liabilities there are specific provisions, for example:-
- duty to disclose material interests in contracts with the company (s 162 Companies Ordinance)
- duty to produce books and provide assistance to investigator appointed by the Financial Secretary (s 145 Companies Ordinance)
- liability for untrue statements in a company prospectus inviting subscription for shares or debentures (s 40(1) Companies Ordinance)
- liability for company's cheques where he fails to add words indicating that he signs the cheque on the company's behalf (s 26 Bills of Exchange Ordinance, Cap 19).

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- Directors generally owe only fiduciary duties to the company, but not to individual shareholders, following the common law position.
- However, in exceptional circumstances where directors place themselves in some other fiduciary relationship with the members, e.g. if the directors acted as agents of the shareholders for the purpose of selling their shares, the directors may owe fiduciary duties to individual shareholders.
- Further, as referred to above, where there are untrue statements in a company prospectus inviting subscription for shares or debentures, the directors are liable to pay compensation to all persons who subscribe for any shares or debentures for the loss or damage sustained by reason of the untrue statement (s 40 of the Companies Ordinance).

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- In general, directors and officers are not liable to third party creditors of the company for negligence or breach of duty owed to the company or for breach of duty by the company.
- However, they may be liable to third parties, for example, for breach of warranty of authority to act on behalf of the company or possibly in respect of a transaction which is beyond the company's powers.
- Further, as referred to above, where there are untrue statements in a company prospectus inviting

subscription for shares or debentures, the directors are liable to pay compensation to all persons who subscribe for any shares or debentures for the loss or damage sustained by reason of the untrue statement (s 40 of the Companies Ordinance).

- If a company goes into liquidation and it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose, any officers or persons who were knowingly parties to the carrying on of the business in that manner are personally responsible for the debts or liabilities of the company (s 275 Companies Ordinance).

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- Where a company has committed an offence, a director is usually guilty of the same offence if committed with his consent or with his knowledge.
- The general position is provided under the Criminal Procedure Ordinance (Cap 221) s 101E: If it is proved that any offence under any Ordinance was committed by a company with the consent or connivance of a director or officer concerned in the management of the company, or any other person purporting to act as a director or officer of the company, that person is guilty of the same offence.
- Specific provisions are contained in other legislation, for example:-
- Dangerous Goods Ordinance (Cap 295) s 16: Where a person by whom an offence under that Ordinance has been committed is a company, every director and every officer concerned in the management of the company shall be guilty of the like offence unless he proves that the act constituting the offence took place without his knowledge or consent.
- Securities and Futures Ordinance (Cap 571) s 390: Where the commission of an offence under that Ordinance by a corporation is proved to have been aided, abetted, counselled, procured or induced by, or committed with the consent or connivance of, or attributable to any recklessness on the part of, any officer of the corporation, or any person who was purporting to act in any such capacity, that person, as well as the corporation, is guilty of the offence and is liable to be proceeded against and punished accordingly.
- As to corporate manslaughter, Hong Kong follows the common law position and there is no legislation on this. Directors and officers can still be prosecuted for gross negligence manslaughter under common law (unlike the position in UK where the Corporate Manslaughter and Corporate Homicide Act 2007 provides that no natural person can be charged for aiding and abetting under the Act).
- Directors may also be disqualified (being prohibited from acting as directors) for a specified period. The court may disqualify a director on conviction of an indictable offence, for persistent breaches of the Companies Ordinance or for fraud in winding-up. As regards insolvent companies, the court has the duty to disqualify unfit directors (including shadow directors) (ss 168C-168H Companies Ordinance).

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- Directors and officers do not automatically assume the duties/liabilities owed by an employer company to the employees. However, if the company commits an offence with the consent or connivance of the director, the director is guilty of the same offence (s 101E Criminal Procedure Ordinance (Cap 221), referred to above).

  Examples of offences in relation to employment are as follows:

  - If an employer company enters into, renew or continue a contract of employment without belief on reasonable grounds that the company will be able to pay wages, the employer company is guilty of an offence and liable on conviction to a fine (ss 31 & 63A Employment Ordinance (Cap 57)).
  - An employer company who wilfully and without reasonable excuse withholds wages for more than 7 days commits an offence and is liable to a fine of HK$350,000 and imprisonment for 3 years (ss 23-25 & 63C Employment Ordinance (Cap 57)).
  - A director is guilty of the same offence if the employer company commits it with his consent or connivance.
  - Directors and officers shall also avoid unlawful acts under the anti-discrimination legislation in Hong Kong (Sex Discrimination Ordinance (Cap 480), Disability Discrimination Ordinance (Cap 487), Family Status Discrimination Ordinance (Cap 527) and Race Discrimination Ordinance (Cap 602) (the Race Discrimination Ordinance only came into operation on 10 July 2009)). For example, it is unlawful for an employer or an employee (which likely includes directors and officers employed) to sexually harass a woman who is seeking to be, or who is, employed by that employer (s 23(1)-(3) Sex Discrimination Ordinance (Cap 480)).

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

- The liquidator may apply to have any officer privately examined as to the affairs of the company and ask for production of documents relating to the company (s 221 Companies Ordinance).
- The directors and officers (including shadow directors) have the duty to deliver to the liquidator all the company's assets and books and records and to give full disclosure of the company's assets and liabilities and other affairs. Failure to do so will render them liable to imprisonment and a fine (s 271 Companies Ordinance).
- Failure to keep proper books of account for the period of 2 years preceding commencement of winding-up renders every officer who is in default guilty of an offence and liable to imprisonment and a fine (s 274 Companies Ordinance).
- Any directors or officers who are knowingly parties to fraudulent trading (any business of the company being carried on with intent to defraud creditors or for any fraudulent purpose) are personally responsible for the debts or liabilities of the company (s 275 Companies Ordinance).
- If the officer has misapplied or retained the company's property or has been guilty of misfeasance or breach of duty, the court may order him to return the money or property or to compensate the company for the wrongdoing (s 276 Companies Ordinance).

8. What remedies are available?

Damages, disqualification, imprisonment and fines, as may be appropriate.

9. Who has the right to claim?

- the company
- minority shareholders of the company
- the Official Receiver, the liquidator, the creditors or the contributories
- third parties; or
- regulators

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

- It is legal to purchase D&O cover and a company may do so.
- Under s 165(3) of the Companies Ordinance, a company may purchase and maintain for any officer of the company (a) insurance against any liability to the company, a related company or any other party in respect of any negligence, default, breach of duty or breach of trust (save for fraud) of which he may be guilty in relation to the company or a related company and (b) insurance against any liability incurred by him in defending any proceedings, whether civil or criminal, taken against him for any negligence, default, breach of duty or breach of trust (including fraud) of which he may be guilty in relation to the company or a related company.
- If the company does not provide such insurance coverage, the directors can by themselves take out insurance policies to cover their liabilities.

11. Are there any corporate procedural prerequisites to effecting cover?

A director shall disclose interests in any D&O cover to be purchased by the company for him, as he has the duty to disclose (at the earliest meeting of directors) material interests in contracts with the company (s 162 Companies Ordinance). For some companies, the Articles of Association may prohibit the director from voting on any contracts in which he has interests and in that case he shall abstain from voting on any resolution for the purchase of the cover.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

- The company will be asked to fill in a questionnaire and/or proposal form. Based on the answers, the insurer may raise further queries or request further documents.
- In the proposal form, the insurer may ask the potential insured to disclose to the insurer every matter that he knows, or could reasonably be expected to know, which is relevant to the insurer's decision whether to accept the risk of the insurance and, if so, on what terms.
- The insurer will conduct an evaluation of the risk liability of the company at the time of effecting or renewal of the insurance policy.

- Issues generally considered by insurer to be assessed are:
  - Corporate governance practice
  - Shareholders profile
  - Business strategy and outlook
  - Overview of operations
  - Territorial exposures/coverage
  - Recent M&A activities
  - Litigation management philosophy and track record of litigation

13. Are there any tax implications connected to the purchase of D&O cover?

The D&O cover purchased by the company is not regarded as assessable income of the director or officer for salaries tax purposes. This is because it is unlikely that the cover is convertible into money by the director/officer and that the premium is a liability of the company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

D&O insurance is not compulsory and is usually purchased by listed companies. It is a recommended best practice for listed companies. The Listing Rules provide that an issuer should arrange appropriate insurance cover in respect of legal action against its directors (paragraph A.1.9 of Appendix 14 (Code On Corporate Governance Practices) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited).

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

It is usually purchased locally (the Hong Kong branch of overseas insurers) through local insurance brokers. The broker usually first has a questionnaire completed by the company and then obtain quotations from a number of insurers. After a quotation is agreed, a proposal is submitted to the insurer.

16. Who are the beneficiaries of the insurance?

- Directors (executive or non-executive) for personal liability
- Officers (including usually senior managers, company secretary or other names person) for personal liability
- Insured company for company liability
- Can be extended to cover former directors & officers, and outside directors (covering directors and officers sitting on boards outside the insured group at the request of the company)

17. What is commonly covered?

- It commonly covers a claim alleging a wrongful act (see further below) of directors and officers for:
  - personal liability of the directors and officers against liability and defence costs
  - the company's liability to indemnify the directors and officers against liability and defence costs
  - The insurance can be extended to cover company securities liability or pay any claims from shareholders for the loss of the value of their shares.
  - Policies may also be subject to per claim basis and/or per year basis.
- 2 points to note:
  - A “wrongful act” must be something done in the capacity of director or officer. A “wrongful act” may not include any acts by directors or officers done on behalf of any charitable organisations or trade associations as they may be considered as outside of the official scope of their duties. Additional coverage or clarification for these shall be sought from the insurers.
  - Usually the company itself, parent or subsidiary companies may be covered as the insured company but associated companies may not be included unless specifically arranged with the insurer. As regards director and officers seconded to work in an associated or unrelated company, cover can be arranged under the main or the associated/unrelated companies' policy.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Policy wordings vary from company to company. Example of common exclusions or restrictions are as follows:

- only covering claims first made or brought against the insured during the policy period and reported to the insurer during the policy period
- excluding existing conditions, fraud and dishonesty, fines, penalties and punitive damages levied by the court or regulators, newly acquired subsidiaries, late notification, actions between parties covered by the same policy, professional services rendered by directors or officers, personal guarantees or undertakings given by directors or officers, libel and slander, pollution liability, personal injury, property damage
- some policies may not provide worldwide jurisdictions coverage.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

The company and the directors and officers covered.

20. What is the procedure for bringing a claim?

As soon as the insured becomes aware of a claim or inquiry or any facts or circumstances that may give rise to a claim or an inquiry during the policy period, the insured must immediately notify the insurer in writing of the same.

Such duty of notification is usually a condition precedent to cover.

In addition, it is a good practice to send to the insurer all press releases or other notices or announcements to shareholders issued by the company (as recommended by The Hong Kong Institute of Chartered Secretaries in its Guidance Note - A Practical Guide to Good Governance).

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

A company may indemnify any officer of the company against any liability incurred by him (a) in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or (b) in connection with any application for relief in proceedings for negligence where he has acted honestly and reasonably, in which relief is granted to him by the court (ss 165(2) & 358 Companies Ordinance).

22. How is the indemnification dealt with in practice?

It is common for the companies to indemnify directors to the fullest extent permissible by law.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

The Companies Registry issued a set of non-statutory "Guide on Directors' Duties" in April 2006.

For listed companies, the Listing Rules set out the principles of good corporate governance in respect of which issuers are expected or encouraged to follow (depending on the level of the recommendations), and are required to give considered reasons for any deviation (Appendix 14 (Code On Corporate Governance Practices) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited).

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

The Standing Committee on Company Law Reform did not recommend the enactment of directors' duties into statute (paragraph 6.15, Consultation Paper on proposals made in Phase I of the Corporate Governance Review, July 2001).

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Under the Hungarian Companies Act and the Insolvency Act, the following persons could be considered as Directors and Officers:

(a) the managing director(s) in the case of a limited company not having the right to issue shares;[1]

(b) the members of the board of directors (i.e. directors) in the case of a private company limited by shares;

(c) the CEO in the case of a private company limited by shares where the general meeting of shareholders decided not to establish a board of directors;

(d) the members of the board of directors (directors) in the case of a public company limited by shares;

(e) the members of the board of directors (directors) in the case of a public company limited by shares where the general meeting decided to merge the board of directors and the supervisory board into one single board;

(f) members of the supervisory board where such is established as a result of either a legal requirement (e.g. the company is a public company limited by shares) or a decision of the general meeting;

(g) members of the supervisory board where there is a supervisory board set up in the case of a limited company or a private company limited by shares, and the general meeting transferred certain management powers of the board of directors to the supervisory board.

(h) persons who had a major influence on the decisions of the company at any time during the three years preceding the date the insolvency of the company was declared provided that, at the time when a situation threatening insolvency occurred, such person did not act in accordance with the interests of creditors and, as a result, the assets of the company decreased.

For the purposes of this analysis:

(a)-(e) are defined as Directors and Officers,

(f) as Supervisory Board Members,

(g) in respect of exercising management powers, as Directors and Officers and, in respect of exercising their supervisory duties, as Supervisory Board Members,

(h) as Shadow Directors.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and Officers must exercise the reasonable care and diligence expected from persons in such position and – with the exception mentioned in answer 7 – they must always promote the interests of the company. Some specific examples are that they must represent the company in front of third parties, courts and other authorities, keep the business secrets of the company, exercise employer's rights over the company's employees, avoid conflicts of interest, ensure that submissions to the court of registration are made in due time and contain correct data, and ensure that the annual financial report is prepared in compliance with the provisions of the Accounting Act.

Directors and Officers are liable to the company for damages in accordance with general civil law liability rules. The liability is joint and several if the Directors and Officers have joint signing powers or are members of a board. However, for the Directors and Officers, the Companies Act sets out certain exemptions from liability:

- if, in the case of a board decision, the director or officer did not participate in the decision making or voted against the decision;
- Directors and Officers may be discharged from their liabilities by the general meeting in respect of the preceding year if the articles of association of the company make such discharge possible;
- in the case of a single shareholder company, the single shareholder may directly instruct the Directors and Officers and, in such case, the Directors and Officers are not liable to the company for damages caused by carrying out such instructions.

Supervisory Board Members have joint and several liability to the company for any damage caused by breaching their obligation to supervise the activities of the company. There are no specific exemptions available for Supervisory Board Members.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In Hungary, the duties and liabilities are established mainly to the company and not to its shareholders directly. However, in the case of a single shareholder company, the single shareholder may directly instruct the Directors and Officers and they are liable to the single shareholder to

carry out those instructions. Directors and Officers are obliged to provide the shareholders with any reasonable information requested and to allow the shareholders to review the books of the company and other documents. Shareholders having at least 5% of the votes may request the Directors and Officers to convene a general meeting.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As a general rule under Hungarian law, Directors and Officers are not liable to third parties, but to the company, and it is the company that is liable to third parties for the acts of the Directors & Officers. However, under the Insolvency Act, Directors and Officers are directly liable to creditors and the liquidator in the case mentioned in answer 7.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are certain crimes that can only be committed by Directors & Officers, e.g. by disclosing false data regarding the financial position of the company, embezzling assets of the company, failing to notify the court of registration of certain data in situations prescribed by law, concealing assets from creditors, unlawfully preferencing a creditor, engaging in an agreement restraining the competition in public procurement.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and Officers exercise the employer's rights over the employees of the company and they are obliged to abide by labour law and rules on health and safety at work. If any damage is caused to the employees in connection with their employment, they can enforce their claims against the company and not against the Directors and Officers.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In the course of a bankruptcy procedure (a procedure to agree with creditors and to reach a moratorium), in accordance with the provisions of the Insolvency Act, Directors and Officers are obliged to exercise their duties without the infringement of rights of the bankruptcy trustee.

In the course of a liquidation procedure (a procedure to terminate the company without a legal successor and to satisfy creditors' claims), Directors and Officers are obliged to prepare closing balance sheets and inventories, tax returns, an environmental report and a report on relevant contracts and liabilities and hand them over to the liquidator. If the Directors and Officers fail to do so, they may be fined.

In addition, the creditors or the liquidator is entitled to claim for damages from the Directors and Officers and Shadow Directors if the Directors and Officers of the company and Shadow Directors, at the time when a threatening insolvency situation occurred, did not act in accordance with the creditors' interests and, as a result, the company's assets decreased.

Directors and Officers and any Shadow Director are exempted from this liability if they can prove that they took every reasonable measure to diminish losses of creditors.

8. What remedies are available?

Directors and Officers, Shadow Director and Supervisory Board Members have unlimited liability for breaching their duties.

In the case of a criminal offence, Directors and Officers may face imprisonment, community service work or a fine.

Directors and Officers may also be fined, e.g. by the court of registration if they fail to make a submission required by law, or by the court if they fail to prepare and hand over certain documents to the liquidator.

9. Who has the right to claim?

In general, the company or, if the company was terminated without a legal successor, the former shareholders of the company are entitled to file claims against Directors and Officers, and Supervisory Board Members breaching their duties set out in the Companies Act.

In an insolvency situation, creditors and the liquidator are also file claims against Directors and Officers, and the Shadow Director.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

D&O liability insurance is legal under Hungarian law. There are no explicit provisions on D&O liability insurance, thus there are no restrictions on who may purchase such insurance.

11. Are there any corporate procedural prerequisites to effecting cover?

There are no rules under Hungarian law on any corporate procedural prerequisites to effecting cover. However, companies are entitled to set out such procedures in their articles of association.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

There is no disclosure required to be given to the company. Under Hungarian law, when entering into the insurance contract, the insured is obliged to disclose all facts and circumstances the insured knows or should have known and are material from the perspective of underwriting.

13. Is insurance of D&O exposures compulsory in respect of any type of company?

D&O cover is not compulsory in Hungary.

14. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance products are not widespread in Hungary. Although providing coverage D&O liability is not mandatory under Hungarian law, as the laws on the liability of Directors and Officers have become stricter in recent years, this type of insurance product is expected to be more and more popular among Hungarian subsidiaries of foreign companies as well as fully domestic companies. Although several local insurance companies (including local subsidiaries and branches of international insurance companies) provide D&O insurance in Hungary, the number of policies purchased from insurance companies registered in Hungary is rather insignificant. In the case of subsidiaries of foreign companies, insurance can be provided on a group level purchased from an insurance company registered in the parent company's country or it is also possible that, in addition to a local policy, a master policy is underwritten in a foreign country.

Among insurance companies in Hungary, reinsurance is commonly used. Hungarian insurance companies are usually covered by foreign reinsurance companies.

THE EXTENT OF COVER

15. Who are the beneficiaries of the insurance?

In Hungary, the beneficiaries are usually the individual Directors and Officers, and the Supervisory Board Members.

16. What is commonly covered?

The most commonly covered events are the damages and losses caused by Directors and Officers, and Supervisory Board Members as a result of their acting in the course of the business of the company. The cover may also extend to regulatory fines and the legal costs of civil law claims. Some insurance companies provide legal assistance in the course of such procedures.

17. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Under Hungarian law, no statutory exclusions exist as there are no special statutory rules on D&O insurance. As D&O insurance products are not widespread in Hungary, there is no common practice of generally applied special exclusions. Some of the policies exclude damages caused by a director/officer to his co-director/co-officer.

BRINGING A CLAIM UNDER THE INSURANCE

18. Who can bring a claim under the D&O cover?

Under the D&O cover, the person specified in the general terms and conditions of the insurer can bring a claim.

19. What is the procedure for bringing a claim?

Any claim must be notified to the insurance company in the form and within a period set out in the general terms and conditions of insurance. Failure to meet this deadline will entitle the insurance company to refuse to meet the claim.

INDEMNIFICATION

20. Can the company indemnify its directors and officers? If so, for what?

There is no such general rule under Hungarian law that would prohibit the company to indemnify its Directors and Officers or Supervisory Board Members. However, as the direct liability of Directors and Officers usually arises in an insolvency situation, such indemnification is not a common practice in Hungary. Where criminal fines are imposed on Directors and Officers, then these fines must be paid from their own assets.

21. How is the indemnification dealt with in practice?

The direct liability of Directors and Officers to third parties usually occurs in an insolvency situation, and an insolvent company is usually not in a position to provide indemnification. Therefore, indemnification of Directors and Officers is not a common practice in Hungary.

ANY OTHER BUSINESS

22. To what extent is corporate governance utilised to shield directors and officers?

The Budapest Stock Exchange (BSE) issued a recommendation to companies listed on the BSE on corporate governance. In the course of preparing the recommendation, the BSE took into consideration the relevant EU soft law. The recommendation is not mandatory, however, if a company does not follow a specific provision of the recommendation, it has to explain the reasons thereof (the comply or explain principle).

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

We are not aware of any anticipated legislative/regulatory changes in the near future in this matter.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

We are not aware of any anticipated legislative/regulatory changes in the near future to the legality of insurance cover/indemnification.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

We are not aware of any particular areas/pitfalls to watch out for. However, as D&O insurance is not widespread in Hungary, the lack of practice could cause inconsistencies.

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[1] From a Hungarian law perspective, owners of a limited company not having the right to issue shares are called members and not shareholders. For the purposes of this summary, unless specifically mentioned otherwise, we use the term shareholders both for members of a limited company not having the right to issue shares and for shareholders of a company limited by shares

India

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Under the Companies Act, 1956 (the "Act") the following officers have been defined to mean 'officers in default':

(i) directors (including whole-time directors or managing directors);

(ii) manager;

(iii) company secretary;

(iv) any other person in accordance with whose directions or instructions the board of directors is accustomed to act; and

(v) any person charged by the board of directors with the responsibility of complying with the provisions of the Act.

The aforesaid officers are liable under all such provisions of the Act which provide that an officer of the company who is in default shall be liable to any punishment or penalty.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Duties of directors of a company can be classified into two categories:

(a) Statutory duties (i.e. duties specified under the Act or any other applicable law), which include the following:

(i) Making filings (as required) on behalf of the company with the regulatory authorities;

(ii) Making disclosures as regards related party transactions.

(b) Common law duties: As directors are agents of the company and trustees of the assets and properties of the company, they have certain fiduciary duties towards the company, including the duty of good faith and due care.

Therefore liabilities of directors can be classified as follows:

(a) Liability for breach of statutory duties: The Act imposes numerous statutory duties on directors under various sections. Default in compliance of these duties attract penal consequences

(b) Liability for breach of common law duties: Directors are held personally liable for any loss or damage resulting from the following:

(i) Breach of fiduciary duty:-Acts of the director in a manner dishonest to the interests of the company;

(ii) Ultra vires acts: Any acts of the directors beyond the parameters of the Act, the Memorandum of Association and the Articles of Association;

(iii) Negligence;

(iv) Mala fide Acts: Any loss or damage suffered by the company if they exercise their power or perform their duties dishonestly or in a mala fide manner;

(v) Misfeasance: Wilful misconduct or willful misuse of powers.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are no separate duties/liabilities which the directors and officers owe to shareholders of a company, from the duties and liabilities owed to the company as such. As regards duties in relation to take over offers and it is the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 which prescribes certain duties.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As directors are agents of a company, the ordinary rules of agency apply to any contract or transaction made by them on behalf of the company. Thus where the directors contract in the name and on behalf of the company, it is the company which is liable and not the directors. Directors incur personal liability towards third parties in the following circumstances:

(i) Liability under the provisions of the Act

(a) With regard to prospectus: For a misstatement in a prospectus (in violation of Section 56 of the Act);

(b) With regard to allotment: Irregular allotment (in violation of Section 69 and 70 of the Act), failure to repay application monies (in violation of Section 69 of the Act), failure to repay application monies (in violation of Section 73 of the Act);

(c) If the Memorandum of Association of the Company stipulates that the liability of the directors is unlimited; and

(d) For fraudulent trading i.e. carrying on the business of the company with the intent to defraud creditors.

(ii) Directors are personally liable to third parties when they contract in their own name;

(iii) Directors are personally liable to third parties when they use the company's name incorrectly;

(iv) Directors are personally liable for transacting any business ultra vires the company or ultra vires the articles of association of the company.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under Indian law there are no specific provisions which deal with liabilities of the directors and officers to the state. Apart from civil liability under the Act, the Income Tax Act, 1961 and under common law, directors may incur criminal liability under the penal code (as regards breach of trust etc.), the Act or other statutes. Under the Act directors shall be liable to imprisonment for many actions including without limitation making an untrue statement in a prospectus, failure to repay deposits (taken by the company) within prescribed periods of time, inviting or accepting deposits beyond prescribed limits, failure to lay financial statements before the shareholders.

Under the Income Tax Act, 1961, a director of a private company in liquidation which is unable to discharge its tax liability is jointly and severally liable to the income tax authorities for such tax liability unless he proves that he is innocent of any neglect, misfeasance or breach of duty in relation to the company's affair.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under section 14A of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 in case of non compliance with provisions in relation to provident fund collections with the consent or connivance of, or attributable to a director or other officer of the company, such director or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly. Under Section 420 of the Act, directors are required to ensure compliance by the company of the obligations imposed upon the Company under Sections 417-419 of the Act in relation to deposit of employee money or securities or deposit of provident fund of the employees in accordance with the provisions of the Act.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Section 542 of the Act provides that if in the course of winding up of a company, it appears that the business of the company has been carried on with the intent to defraud the creditors of the company or any other person or for any fraudulent purpose, the directors can be held to be personally liable without any limitation of liability, for all or any of the debts or liabilities of the company. Section 427 of the Act provides that in the winding up of a limited company, any director, or manager, with unlimited liability shall be liable to make a further contribution as if he were, at the commencement of the winding up, a member of an unlimited company.

8. What remedies are available?

The remedy available would differ somewhat based on the entity seeking the remedy. The company and the shareholders have the following remedies available to them:

(a) injunction;

(b) restoration of company property;

(c) account of profits;

(d) dismissal;

(e) damages, etc.

Third parties have the following remedies available to them:

(a) repayment;

(b) restitution;

(c) compensation; or

(d) damages.

9. Who has the right to claim?

The affected party including the provident fund authorities in case of provident fund dues.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

As under Section 201 of the Act, a company cannot indemnify a director against liability arising pursuant to negligence, default, breach of duty, misfeasance or breach of trust of which he may be guilty in relation to the company, However, the proviso to this section permits a company to indemnify directors against any liability incurred by them in defending any proceedings in which judgment is given in their favour. The said section however, does not prevent a company from taking out an insurance policy for its own protection against loss caused to it by its directors. The director can also take out a policy to recompense the loss he suffers because of his liability to the company. The premium for such policy may be reimbursed by the company. This will not be in contravention of the section since the company does not agree to indemnify the directors against his liability to it, but, merely agrees to meet the expense of procuring an undertaking from the insurer to do so.

Thus, D&O insurance is usually purchased by the company itself, with the directors and officers as beneficiaries. The policy is normally taken in the name of the parent / holding company and provides protection to the directors and officers of the company and also the directors and officers of all subsidiary companies.

11. Are there any corporate procedural prerequisites to effecting cover?

There are no stipulated corporate procedural prerequisites to effecting cover.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

There are no statutory or regulatory disclosure requirements stipulated in order to obtain D&O cover.

13. Are there any tax implications connected to the purchase of D&O cover?

The premium paid by the company is ordinarily deductible as a business expense. The amount received pursuant to a D&O insurance cover by the company would ordinarily be taxable as a business receipt in the hands of the company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No, it is not mandatory for companies (other than those seeking to get listed on offshore stock exchanges) to obtain compulsory D&O insurance cover. However it has been reported that pursuant to the scam involving Satyam Computer Services Limited (Mahindra Satyam), coming to light, the capital markets regulator Securities and Exchange Board of India will make it mandatory for all listed companies to buy D&O liability cover.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

Resident Indians including Indian companies cannot purchase policies from offshore insurers without prior Reserve Bank of India permission. Local insurance companies offer D&O insurance so it is usually purchased locally. The risk is then spread out to the global reinsurance market.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

Beneficiaries of the insurance can be the company, the director and officers (past, present or future directors and officers) can also be covered.

17. What is commonly covered?

D&O insurance provides re-imbursement to the company arising out of claims against directors and officers in relation to acts, omissions, errors, misstatements, misleading statements made or done by them in the performance of their duties towards the company, which are not fraudulent or pursuant to the wilful negligence of the directors.

Policies could cover claims in relation to errors in annual accounts, wrongful dividend payment, conflict of interest, mismanagement of funds, unfair allotment of shares, etc.

D&O policies can provide insurance cover for 'independent directors' in relation to claims arising out of 'their ignorance of the day to day happenings in the company.'

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

(a) Nothing. It is the indemnification by the company that is prohibited and the company funding the purchase of the cover is not prohibited. It needs to be noted that the provision is not by way of prohibition (as to the company providing indemnification), rather it is by way of a stipulation that any provision from exempting any officer from or against any liability etc. shall be void. This and the absence of the term 'indirectly' in the provision has resulted in this loophole.

(b) Fraudulent and/or intentional acts or omissions of an insured, the gaining of any profit or advantage to which the insured was not legally entitled, acts committed prior to the inception date of the policy, libel, slander or other defamation, environmental damage or pollution, bodily injury or property damage, fines, penalties and other penal liability, professional errors and omissions, infringement of copyright or patent, in a capacity as trustee or fiduciary under law.

Typically, director liability policies exclude liability for criminal wrongs, fines and penalties for civil

wrongs, litigation, personal injury or property damage and infringement of intellectual property rights.

General exclusions to the policy are dishonest fraudulent criminal or malicious act, personal guarantee, libel and slander and damage to property, pollution damage and violation of any law.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

The Company or the beneficiaries as named in the policy document.

20. What is the procedure for bringing a claim?

The insured should within the period specified in the policy notify the insurance company in writing of claims received by it. The insurance company would normally take over the conduct of the legal proceedings and become joint respondents to the case along with the insured. All amounts expended by the company in such proceedings would constitute defence costs and form part of the claim payable under the policy subject to the limit of indemnity mentioned as 'sum insured' in the policy and subject to the insured not having breached any of the terms of the policy.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

No. Please see our response to question no. 10 above.

22. How is the indemnification dealt with in practice?

Please see our response to question no. 10 above

ANY OTHER BUSINESS

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

The proposed Companies Amendment Bill, 2008 seeks to reinforce shareholders democracy and the liability of Board of Directors and senior management personnel of companies and provides for a new scheme for penalties and punishment for non compliance or violation of the law. The Companies Amendment Bill 2008 also provides for class action law suits, which could expose directors to expensive litigation.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No. The Companies Amendment Bill 2008 does not specifically deal with the legality or the extent to which D&O Insurance is permissible. Further currently there is no proposal from the insurance regulator in relation to codification of the law on D&O insurance.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Please see our response under question no. 18(a) above. It maybe prudent for the directors to fund the purchase of D&O policy and then be reimbursed by the company. This is to mitigate the loophole referred to in question no. 18(a) above being struck down by courts and as a result in the policy being held to be void because it was originally paid for by the company.

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

The Israeli Companies Law - 1999 ("the Companies Law") defines a "director" as: "a member of the board of directors of the company and a person actually serving in the position of director, whatever his title may be".

The term "office holder" means: "a director, general manager, chief business manager, deputy general manager, vice general manager, any person filling any such position, even if he holds a different title, and any other manager directly subordinated to the general manager".

(The terms "office holders" in this article includes directors).

Pursuant to the Companies Law, a corporation may serve as a director of a company, so long as it appoints a designated person to act on the board on its behalf. Both the corporation and the designated person have joint and several liability.

The Companies Law also refers to a substitute director, and provides that the same set of rules applies to him as that which applies to any director. Nomination of a substitute director does not discharge the principal director from liability, which will continue to attach pursuant to the circumstances of each individual case.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Companies Law imposes two main duties on the office holder, namely - the duty of care and fiduciary duty. Section 252 of the Law provides that an office holder has a duty of care towards the company. Such duty is tortuous by nature, and does not preclude a duty of care, in general, towards third parties.

Section 253 of the Companies Law sets out the precautionary measures and degree of proficiency which the office holder must exercise: "An office holder shall act with a standard of proficiency with which a reasonable office holder, in the same position and in the same circumstances, would act; This shall include taking reasonable steps, in view of the circumstances of the case, to obtain information regarding the business value of an act submitted for his approval or an act done by him by virtue of his position, and to obtain any other pertinent information regarding such act".

Section 254 of the Companies Law sets out the fiduciary duties of an office holder. He should act in good faith for the company's benefit, and must:

- Avoid actions which may constitute a conflict of interest between his position in the company and his personal matters;
- Avoid competition with the company's business;
- Avoid exploitation of the company's business opportunities in order to enhance his personal interests;
- Disclose to the company all information or documents relating to the company's business which he obtained by virtue of his position.

The fiduciary duty is wider in scope than the duty to act in good faith, which is one of the fundamental principles in Israeli law in general. A person may act in good faith but still look out for his personal interests, whereas the duty of loyalty (fiduciary duty) completely precludes the office holder from considering any of his personal interests in execution of his office.

Breach of the office holder's duty of care towards the company creates a cause of action in tort against him, and the usual legal principles will apply (i.e. liability will depend upon reasonable foreseeability). Breach of the office holder's fiduciary duty is deemed a breach of his contract with the company, and normal contractual relief may be sought.

Derivative Claims by Shareholders, Directors or Creditors

The Companies Law provides that any shareholder and any director of the company may file a derivative claim on behalf of the company, subject to receipt of the court's approval. By their nature, derivative claims are submitted on behalf of the company, following the company's refusal to submit such claims. Invariably, such refusal will occur when the potential defendants are the company's directors and officers. Creditors may file a derivative action on behalf of the company in cases where a "prohibited distribution" has been executed. This term includes distribution of profits and purchase of the company's shares without the company having sufficient capital assets to do so or without the court's approval.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Securities Law - 1968 ("the Securities Law") imposes liability on the company's directors and its general manager in cases of misleading or incomplete information in the company's prospectus and financial statements. The claimant may be both the purchaser of a first issue of securities in reliance on the company's prospectus and a purchaser of securities in the secondary market. The Securities Law imposes strict liability on the offending party. The general manager and the directors of a public company have a duty to render immediate notifications to the Companies Registrar and the Securities Authority in respect of material matters which may be of interest to the reasonable investor. In respect of publicly traded

companies, such notification must also be given to the Stock Exchange.

Recent Supreme Court judgments have set out who has the right to sue for breach of the above duties. Where the company sustained a direct loss as a result of its officeholders' wrongdoing, only the company may sue the officeholders (either directly or derivatively), even if the company's shareholders sustained a loss of a secondary nature as a result of deterioration in the value of their shares. This does not mean that the shareholders are precluded from suing the office holders. The shareholders do have a direct cause of action against the officeholders, which is: (a) independent from the company's cause of action; and (b) based on a legal provision which establishes a direct duty of care of the company office holders to them.

The Class Action Law - 2006 allows any person who has a cause of action deriving from an interest in securities ("an interest" is defined as: ownership, possession, purchase or sale") to file a class action. Over the past few years, many directors and officers have been named defendants in class actions filed by securities holders.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Third Parties in Tort

Principles which evolved in case law and are now recognized in the Companies Law, provide that the fact that a person is an office holder or an organ of a company does not afford him immunity from liability in tort. An office holder who has committed a civil wrong may not hide behind the corporation's separate legal entity. His actions will be judged like those of any individual and he may be held liable in tort pursuant to the ordinary principles which establish such liability. Generally speaking, in order to establish the duty of care of an office holder, a factual foundation must be set out which shows a higher level of involvement than merely executing usual and routine actions in the company. Cases where personal liability was imposed on office holders include situations where the office holder had personal expertise relevant to the transaction and which the other party relied on, and where there was a special relationship between the office holder and the third party, which the latter relied on. Personal liability has also been held to attach when the office holder withheld material information from the third party.

Third Parties in Contracts

As a rule, an office holder will not be held personally liable for contractual obligations undertaken by him on behalf of the company, so long as the office holder has not assumed personal contractual liability. An exception to this rule can be found in cases of breach of the contractual duty to act in good faith and a customary manner during negotiations for formation of the contract and the execution thereof. Such breach may occur if the office holder withholds material information from the counter party which is essential to such party's decision to execute the contract.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Various laws impose criminal liability on office holders for violations committed by the company. Many laws impose strict liability. In effect, imposition of strict liability reverses the burden of proof. The office holder may be exempt from culpability if he can prove an accepted defence. Most of the available defences require proof that the office holder was unaware that the offence had been committed and that he had taken all reasonable measures to prevent its perpetration.

One finds such laws in a wide range of subjects, including: securities laws, tax laws, environment protection laws (including prevention of pollution and maintenance of hygiene), antitrust laws, safety in the workplace laws, various labour laws and the consumer protection law.

Several provisions of the Penal Code establish specific crimes of corporate office holders, such as:

- False registration in company documents
- Prejudicing the company's ability to meet its obligations
- Fraud and breach of trust.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Various Israeli labour laws afford protection to employees. Some of these laws relate to the following matters: equality of rights in the workplace, prevention of sexual harassment, youth labour, equality of rights for disabled persons, etc. Many labour laws impose personal criminal liability on office holders for their breach. Civil liability will arise pursuant to general legal concepts and may attach to office holders based on causes of action in tort (negligence and breach of statutory duty) or as a result of breach of the duty to act in good faith and in a customary manner.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Companies Law annulled the previous Companies Ordinance except for matters relating to liquidation. Sections 373 and 374 of the Companies Ordinance (which deal with fraudulent trading and misappropriation of the company's assets) call for imposition of personal liability on office holders. Office holders may be liable to compensate the company for losses sustained as a result of their actions. In cases of fraudulent trading, officeholders may be liable for the full extent of the company's debts. Such exposure is especially severe as there is no requirement that a causal connection exist between the office holder's wrongdoing and the liquidation.

Section 374 empowers the court (in most cases, this will be a court-appointed officer, being the liquidator or administrative manager) to interrogate the office holders with a view to obtaining information about the company's business prior to the liquidation proceedings. It seems that the office holder must answer all questions and may not exercise his right to avoid self-incrimination. It is also doubtful whether he may be accompanied by a lawyer. As a result of such interrogation, the office holder may find him/herself sued personally. Thus, a liquidation interrogation subjects the office holder to a risk even more severe than a criminal investigation undertaken by the police or other investigative authority (such as the Securities Authority or Antitrust Authority).

8. What remedies are available?

Award of compensatory damages, declarative orders, fines, criminal penalties (including imprisonment).

9. Who has the right to claim?

All parties mentioned in the previous Section. In addition, any director who has reasonable grounds to believe that an office holder of the company is about to carry out an act which may constitute a breach of his duties towards the company, may apply to court with a request to enforce the duty or seek an injunction against such office holder, to prevent the execution of such act.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

An issue which arises is whether the company may acquire insurance for the office holders' costs in criminal proceedings. The Companies Law does not provide an answer on this issue. However, the accepted practice in Israel is that insurance for office holders' liability may be effected in all cases where indemnification by the company is permitted. Israeli Courts have not yet had the opportunity to decide on this matter.

There is no prohibition on an individual office holder to purchase insurance to cover his liability.

11. Are there any corporate procedural prerequisites to effecting cover?

The Companies Law provides that an office holder may be discharged or indemnified or Insured by the company, only pursuant to the terms and conditions set out in this law. A company is permitted to insure or discharge its office holder only if a relevant provision subsists in the articles of association. The company's articles of association may include an indemnification undertaking, which permits the company to effect a future undertaking to indemnify the office holders. Such undertaking must be restricted to those cases which the board of directors anticipates might occur at the time the indemnification is given. The indemnification amount must be deemed by the board of directors to be reasonable in the circumstances of the case. An alternative method of indemnification refers to indemnification post-factum, which also requires an appropriate provision in the company's articles of association. An additional procedural requirement is a decision by the board of directors, and in some cases also by the audit committee and ratification by the general assembly.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

The Israeli Insurance Contract Law - 1981 ("the Law"), as well as court precedents have narrowed the scope of disclosure required from an insured prior to the inception of the insurance contract. The Law provides that prior to inception of the policy, the insured has a duty to respond in a sincere and complete manner to questions asked by insurers in a proposal form. Furthermore, an insured also has a duty to initiate disclosure of material information, so long as he was aware of the materiality of such information. In practice, Israeli Courts of law have given a very narrow interpretation to the duty to initiate disclosure, and have placed emphasis on questions actually asked by insurers. Many court cases have determined that if insurers did not deem it necessary to ask a specific question, then, they no doubt did not consider it material, and therefore the assured should not be deemed as having the duty to initiate on his own accord disclosure of information on such matter.

Having said that, in the last couple of years a trend can be perceived towards relaxation of the aforesaid rule. In the Supreme Court decision of C.A. Menorah Insurance Co. Ltd. v. Yuvalim, PDA 58(6) p. 822, it was held that especially in claims made policies with retroactive coverage, the insured has increased disclosure duties towards his insurer, and a material matter which the insured was aware of prior to inception of the policy and did

not disclose to the insurer in the insurance proposal will not be covered under the policy.

Non disclosure by the assured, including an incomplete or insincere answer to a question in the proposal form, may justify policy rescission, so long as the insured event has not occurred. Otherwise, insurers' remedies are limited to payment of partial insurance benefits proportionate to the premium that was charged and the premium that would have been charged had they been aware of the facts. Insurers may be totally discharged from liability in case of fraud by the insured or if a reasonable insurer would have refused to accept the risk, even for a higher premium.

Pursuant to Section 8 of the Law, the insurers will not be entitled to the remedies discussed above, except in the case of fraud, if they knew or ought to have known the true facts, or if they themselves were the cause for the incorrect or incomplete answer (e.g. by drafting vague or incoherent questions). Another important factor is the causal connection issue. If the insured can show that the incorrect answer did not affect the occurrence of the insured event, the insurers' liability or its extent, the insurers will not be permitted to rely on the prescribed remedies for non-disclosure.

13. Are there any tax implications connected to the purchase of D&O cover?

Insurance purchased by the company for its office holders is not subject to payment of any taxes by the office holder. Premiums are exempted from V.A.T. Premium paid by a company for its directors and officers' liability policy is an income tax deductible expense. If the office holder is indemnified by the company or the insurer in respect of loss he incurred and paid due to his liability, such indemnification is not subject to payment of any tax.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

Under Israeli law certain financial institutions (such as provident funds and their management companies, mutual trust funds, portfolio managers and investment consultants) must acquire professional liability insurance and dishonesty of employee insurance. D&O insurance is not among the compulsory insurance requirements.

The Commissioner of Banks requires all Israeli banks to acquire BBB policies. It is not clear whether D&O cover is mandatory pursuant to this directive.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance is purchased both from local insurance companies and from foreign insurers. Local companies usually reinsure risks exceeding several hundreds of thousands of dollars with foreign reinsurers.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The insureds under a D&O policy are the individual directors and officers. The common practice is to also include Company Reimbursement Cover when the company is required or permitted under law to reimburse its office holders for claims made against them. Entity cover endorsements, covering claims against the company itself, usually against securities claims, are sometimes issues.

17. What is commonly covered?

In general, D&O policies issued in Israel provide indemnification in respect of liability incurred by directors and officers following claims for wrongful acts in their capacity as directors or officers in the course of the business of the company. Cover is extended not only to the amount of any judgement or settlement, but also to the defence costs incurred for the defence of the office holder.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Under the provisions of the Companies Law, a company is not permitted to effect insurance, to indemnify or to release its office holders in cases of: (a) Breach of trust, unless carried out in good faith and with reasonable grounds to believe that the acts would not prejudice the company; (b) Breach of duty of care which was carried out intentionally or recklessly, unless carried our merely by negligence; (c) An act carried out with the intent to gain unlawful personal gain; (d) A fine or penalty imposed on the office holder.

As a matter of common practice, the most common exclusions in D&O policies issued in Israel refer to claims regarding: the gaining in fact of personal gain to which the insured was not legally entitled, the committing in fact of a dishonest or fraudulent act, pollution, bodily injury and property damage.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

(a) The Policyholder (usually the company).

(b) The insured office holders

(c) Pursuant to Section 68 of the Law, a third party has privity of contract with a liability insurer. The insurer may, and at the request of the third party must, pay to the third party the insurance benefits owed to the insured by the insurer, provided that the insurer notified the insured in writing thirty days in advance and the insured does not object.

20. What is the procedure for bringing a claim?

The Law provides that the insured must notify the insurer immediately upon becoming aware that an insured event occurred. When notice of the insured event has been delivered to the insurer, the insurer must immediately carry out investigations do what is necessary to ascertain his liability. The insured must deliver to the insurer, within a reasonable time after being requested to do so, the information and documents required for ascertaining the insurer's liability, and if they are not in his possession, he must, to the best of his ability, assist the insurer to obtain them.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Section 260 of the Companies Law provides that a company may indemnify its office holder in respect of liability which may be imposed upon him as a result of an act carried out in his capacity as an office holder, in respect of the following:

(a) Monetary liability towards a third party pursuant to a court judgment or settlement or arbitration award;

(b) Reasonable legal costs incurred by the officeholder in an investigation carried out against him by a competent authority and which terminated without the filing of an indictment against him or without imposition of a monetary obligation as an alternative to criminal action, or which terminated without the filing of an indictment, however – with imposition of a monetary obligation as an alternative to a criminal action in an offence which does not require proof of criminal intent.

(c) Reasonable litigation costs incurred by the officeholder or imposed on him by the court in respect of the following proceedings: (1) action brought against him by the company or on its behalf (2) action brought by a third party (3) criminal charges from which he was acquitted (4) criminal charges where he was found guilty of an offence which does not require proof of criminal intent.

22. How is the indemnification dealt with in practice?

Most companies indemnify their office holders to the fullest extent permitted by law. The company often provides its office holders with letters of indemnification defining the scope of the company's indemnification undertaking.

ANY OTHER BUSINESS

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Double insurance and "excess provisions" – Pursuant to the Insurance Contract Law, in case of double insurance, the insured may obtain insurance benefits from any insurer, and it is then up to such insurer to seek contribution from other insurers who have also assumed the same risk. In the Supreme Court case of A. Dori Engineering Works v. Migdal Insurance Co. Ltd., PDI 55(5) p. 566, the Court determined that "other insurance provisions", pursuant to which the insurers stipulate that their policy only applies where no other policies are available, contradict the double insurance clause of the Law and are therefore void. Of course, if agreement is reached between the various insurers, such agreement will govern the legal relations.

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Italian company law contemplates two forms of limited liability corporations: (i) "Società per Azioni" or "S.p.A." (joint stock company); (ii) "Società a Responsabilità Limitata" or "S.r.l." (limited liability company).

Società per Azioni

Three alternative models of governance are available for the S.p.A.:

(i) the *Traditional System*, based on a management body (i.e. a sole director or a board of directors) and a board of statutory auditors, both appointed by the shareholders' meeting;

(ii) the *Dualistic System*, based on a supervisory board appointed by the shareholders' meeting and a management board appointed, in turn, by the supervisory board.

(iii) the *Monistic System*, based on a board of directors appointed by the shareholders' meeting and a management control committee appointed by the board of directors among its members.

Under Article 2392 of the Italian Civil Code, members of the management bodies are jointly and severally liable for damages suffered by the company as a result of a breach of fiduciary duty.

Finally, Article 2396 of the Italian Civil Code extends the liability of directors to general managers "*appointed by the shareholders' meeting or by provision of the by-laws, in relation to duties entrusted to them*".

Società a Responsabilità Limitata

The S.r.l. may choose among the following governance models: (i) sole director; (ii) board of directors; (iii) a number of directors whose unanimous consent is required for all management decisions; (iv) a number of directors, each having full managing authority.

Under Article 2476 of the Italian Civil Code, directors are liable vis-à-vis the company for damages resulting from breach of the duties set forth by law or provided by the by-laws of the company. Such liability does not extend to directors who can establish lack of negligence in their conduct and formal dissent to the prejudicial transaction.

De Facto Directors

According to case law, liability of directors and officers of a S.r.l. or a S.p.A. may be extended to *de facto* directors, i.e. individuals who have managed the company (or interfered with its management) in the absence of a formal appointment, provided that managing functions have been performed in a systematic manner.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In broad terms, the legal standards for directors' duties may be categorized as:

(i) *duty of care*: directors must perform their duties with the diligence required by the nature of their office and their individual skills;

(ii) *duty of loyalty*: each director has the obligation to disclose to the other members of the management body, as well as to the supervisory board, any interest - even if not in conflict with the company - that the director might have (even on behalf of third parties) in connection with each corporate transaction;

(iii) *duty of information*: each director has the obligation to be duly informed when acting or taking management decisions; to this end, under Article 2381 of the Italian Civil Code, managing directors have an obligation to report "*to the board of directors and the board of statutory auditors, on a periodical basis according to the schedule established under the by-laws and in any event at least every 180 days, about the general performance of the management and its predictable evolution as well as on the most important transactions, as to their size or characteristics, performed by the company and its subsidiaries*".

Limitations and Exemptions

When certain powers are delegated to an executive committee or a managing director, the other members of the board may avoid individual liability. Nevertheless, such exemption does not apply to directors in breach of the general duty to supervise the management of corporate affairs (e.g. absent from board meetings) if – albeit being aware that harmful acts to the company are likely to be performed – they fail to use their best effort to prevent such harmful conduct or reduce the prejudicial effects.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Article 2393 of the Italian Civil Code holds directors liable to the corporation for breach of their fiduciary duty (the relevant action being subject to the shareholders' approval by means of a resolution), while Article 2393-bis of the Italian Civil Code grants to shareholders representing at

least 1/5 of the corporate capital the authority to institute (the Italian equivalent of) a "derivative action". Any damages awarded as a result of such initiatives are to the benefit of the corporation itself and not of the individual shareholders.

Directors may also be liable, on the grounds of tortious liability, to individual shareholders who have suffered personal damages as a direct consequence of the directors' culpable conduct (the so called "direct damages", which do not include, *inter alia*, the loss of net worth or of corporate assets or shares, to be redressed through the institution of direct action of the company or the Italian equivalent "derivative action").

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers are liable vis-à-vis third parties (including creditors) for damages directly caused by their negligent or malicious conduct.

To assert an individual claim, a plaintiff must establish: (i) that the alleged misconduct of directors has affected his personal assets and that such prejudice does not merely derive from damages suffered by the corporation; and (ii) that the defendants have caused the prejudice in their capacity as directors or officers of the company. Any recovery is to the benefit of individual plaintiffs, and not of the corporation.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Italian Civil Code (and other statutory instruments) sets forth several criminal offences of directors and officers, including inter alia false corporate reports, hampering control on the company, undue repayment of corporate capital, unlawful distribution of dividends and reserves, fraudulent transactions on securities, transactions detrimental to creditors, false establishment of corporate capital, misappropriation of company assets, obstacles to the exercise of public control, illegal influence on general meetings of shareholders, market rigging, etc.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers might be personally liable for physical injury or death of employees, if plaintiffs may establish that the representatives of the company acted negligently or could have prevented the damage with due diligence. Under certain circumstances, directors or officers might be personally liable for claims brought by employees for sexual discrimination or harassment. Naturally, directors and officers are liable under the principles of tortuous liability set forth by the Italian Civil Code.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As a general rule, Article 2394-bis of the Italian Civil Code (applicable only to S.p.A.s) provides that in the event of insolvency procedures, all the liability claims described in the previous paragraphs may be brought by the liquidator/receiver.

8. What remedies are available?

The remedy is the award of compensatory damages.

9. Who has the right to claim?

Società per Azioni

The company, following a resolution of the shareholders; a "derivative action" may be instituted by shareholders representing at least 1/5 of the corporate capital (unless the by-laws provide for a different quorum); creditors; liquidator/receiver; a single shareholder (under certain circumstances); third parties.

Società a Responsabilità Limitata

The company; under Article 2476 of the Italian Civil Code a "derivative action" may be instituted by each quotaholder – irrespective of its quota of corporate capital – without a prior resolution; creditors; third parties. The possibility for a liquidator/receiver to bring an action against directors and officers is disputed by scholars and case law.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of insurance for D&O liabilities in private companies is legal in Italy; such insurance products are usually purchased by the company.

And specifically:

- Corporations
- Cooperatives companies
- Foundations
- Partnerships
- Private bodies
- Private bodies that carry out a public service
- Consortiums.

11. Are there any corporate procedural prerequisites to effecting cover?

Normally the board of directors proposes the purchase of a D&O coverage to the shareholders' meeting; in case of approval, the company will enter into a D&O policy in favour of the Directors and Officers.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

It is custom practice for insurance companies to require the disclosure by the insured of any information that could affect the assessment of the risk and the consequent calculation of the premium.

Specifically, the company (and/or sometime the directors and officers) are required to fill in a proposal form and specify any known circumstance that may have an influence on the risk assessment and that may give rise to a claim against them (e.g. the proposal form normally asks whether directors and officers ever held office in a company declared bankrupt).

13. Are there any tax implications connected to the purchase of D&O cover?

The decision n. 178/E of the Italian Revenue Agency dated 9 September 2003 states that premiums paid for D&O coverage are not taxable fringe benefits, but that such premiums are deductible costs for the company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

In Italy the execution of a D&O policy is not mandatory.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance is usually purchased both locally (i.e. Italian corporations, Italian branches of foreign corporations, foreign corporations) and from overseas market.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

In Italy insureds under a D&O policy are commonly the directors, the statutory auditors and certain specific the officers of a company, who are covered by any loss arising from a claim brought against them by the company, the company's creditors or by third parties. In some cases, where the company indemnifies directly the beneficiaries, then the reimbursement is directly paid to the company (if so provided by the policy).

17. What is commonly covered?

Most D&O policies are written on a "claims made" basis. Normally the insurer indemnifies any of the beneficiaries of the insurance for any financial loss arising from or consequent to any claim brought against the beneficiary during the insurance period or during the discovery period (if provided by the policy), by reason of wrongful acts performed with negligence (gross or slight).

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

There are a number of exclusions normally encountered in D&O policies that may or may not be specific to such kind of insurance product.

Therefore, it may be convenient to point out separately:

(a) Exclusions common to policies covering civil liability

The insurance company shall deny the compensation for the losses arising from:

- Any intentional or fraudulent act committed by the insured;
- Any use of radioactive energy;
- War and terrorism;
- Lack of execution or renewal of an insurance contract;
- Any criminal act committed by any insured
- Circumstances known at inception.

(b) Specific exclusions for losses arising from pollution

(c) Specific exclusions related to the D&O policies

The insurance company shall deny indemnification for the losses arising from:

- The insured's gain of undue or legal profit and/or advantage;

- Any kind of penalties, fine or fee charged to the directors or officers;
- Any activity of trustee, manager or director of a pension fund;
- Any bid, sell or issue of shares of the company, or arising from a merger, acquisition or corporate split;
- Any claim arising from an activity carried out by an insured person in a USA or Canadian company;
- Any claim arising from physical injuries, illness, death or mental disease of any insured person;
- Any claim arising from a circumstance previously communicated by the insured to another insurer.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

All the beneficiaries of the insurance, i.e. the policyholders.

And specifically:

- The directors
- The statutory auditors

If so provided by the policy, former and future directors/statutory auditors of the company may be covered.

20. What is the procedure for bringing a claim?

Normally the policyholder sends a claim notification to the insurers reporting his receipt of a compensation/damages request (or a circumstance) and requesting indemnification for any loss subsequent to such claim.

Pursuant to Article 1913 of the Italian Civil Code, the insured should inform the insurers about the claim within a three-day term (which is not a mandatory term and might be adjusted by the parties). Failure to meet such deadline (wilfully or with culpa grave) may entitle the insurer to deny or limit coverage.

The insured frequently joins the insurer in the proceeding brought against him, (especially when no confirmation of coverage is issued by the insurer) so to have the judge decide on the indemnity issue.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

The company can indemnify the directors and officers only with reference to specific areas that have been identified beforehand.

In such cases, some D&O policies sometime provide for clauses specifically stating that the insurance company shall give compensation to the company that has indemnified its directors and officers for the losses suffered by reason of a wrongful act.

22. How is the indemnification dealt with in practice?

The indemnification procedure has to be specifically agreed between the company and the directors and officers.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

Following the recent Reform Act of Company Law, the liability boundaries of directors and officers have been definitely broadened and the risk of financial losses has increased. Therefore, it may be inferred that D&O policies will increase their presence in the Italian insurance market.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

The recent Reform Act of Company Law has broadened the boundaries of D&O liability and at this stage changes regarding the extent of such liability are not foreseeable.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

At the present time, there are no circumstances suggesting any legislative plan to make D&O insurances illegal, without prejudice for the limitations provided for by the law.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Italian Courts of first instance have occasionally maintained that claims-made clauses are null and void under Italian law. For instance, in a decision rendered on April 8, 2008, the Court of Genova ruled that claims-made clauses conflict with the loss-occurrence set forth by Article 1917 of the Italian Civil Code and deprive insurance contracts of its basic rationale (i.e. the transfer of risk from the insured to the insurer).

It is to be noted that the issue was addressed by the Supreme Court in decision n. 5624/2005, according to which insurance policies based on the claims-made model are valid, although atypical, contracts and require specific approval in writing by the policyholders.

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Mexico 1

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Pursuant to the Mexican General Law of Business Organizations (*Ley General de Sociedades Mercantiles*) ("LGSM"), in the case of Mexican limited liability stock companies (*Sociedades Anónimas*), which is the most popular form adopted by corporations, responsible Directors are individuals appointed as members of the Board of Directors ("Directors") in a duly convened Shareholders' Meeting, and responsible officers[1] (*gerentes*) ("Officers") are individuals appointed as officers in a duly convened Shareholders' or Board Meeting.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Liabilities of Directors

Pursuant to the LGSM, *Sociedades Anónimas* may hold Directors liable for damages and loss of profit expectancies (*daños y perjuicios*)[2]. Generally, Directors would be deemed responsible for any such damages and loss of profits expectancies by virtue of their negligence, willful misconduct or violation of law[3].

The LGSM specifically sets forth the case where Directors may be liable for damages and loss of profit expectancies as follows:

(a) Jointly with the directors that preceded them, for acts or omissions in which the predecessors were at fault, unless the Directors disclose or denounce such acts or omissions in writing to the statutory examiners (*comisarios*) of the respective Sociedad Anónima;

(b) Jointly with the other Directors for fault or deficiency in maintaining accounting books and other books, files and records of the respective *Sociedad Anónima* pursuant to the terms of applicable laws;

(c) Jointly with the other Directors for any delay in filing an annual report on the business and operations of the Sociedad Anónima to the respective General Ordinary Shareholders' Meeting;

(d) Jointly with the other Directors for failure to account for capital contributions;

(e) Individually, if the Directors have a conflict of interest with the Sociedad Anónima, and fail to disclose same to the other Directors, cast a vote and/or participate in discussions leading to the casting of vote where the matter under discussion and vote is connected with such conflict of interest;

(f) Individually, whenever the Directors improperly resolve on the distribution of dividends;

(g) Individually, whenever the Directors allow the Sociedad Anónima to acquire its own shares of stock other than by judicial order or pursuant to the applicable provisions of the Securities Market Law (*Ley del Mercado de Valores*); and,

(h) Individually, whenever the Directors fail to carry out a resolution of the shareholders of the Sociedad Anónima when they are specifically ordered to do so[4].

Liabilities of Officers

Officers of the *Sociedades Anónimas* may be liable for damages and loss of profit expectancies by virtue of their negligence, willful misconduct or violation of law. The LGSM provides no other specific causes whereby Officers may be held liable.

Limitations and Exemptions

Exemption from liability

Directors, who express their disagreement with a given act during the deliberation and resolution of such act at a Meeting of the Board of Directors or where not present at the Meeting would not be liable for such act, unless they acted with willful negligence.

Limitation on liability

In general, Directors shall comply with the responsibility of their offices and with those obligations imposed to them by law or in the by-laws. Therefore, their liabilities shall be limited to the terms and conditions set forth in law and to the specific instructions given to them by the shareholders.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors will have the following duties/liabilities to the shareholders:

a) Execute out the resolutions of the Shareholders' Meetings;

b) Disclose important information to shareholders;

c) Prepare and file with the shareholders an annual report on the financial status of the *Sociedad Anónima* and the operations carried out by the same; and

d) Protect the interest of the Shareholders.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to Mexican law, Directors and Officers may be held liable before third parties for any damages and loss of profit expectancies only if the Directors and the Officers acted outside the scope of their corporate authority (powers and authority) granted to same by the *Sociedades Anónimas*.

Indemnities in favor of the Directors and the Officers contained in the Charters and By-laws of the *Sociedades Anónimas* for liabilities incurred by same, vis-à-vis, third parties when acting on behalf of the *Sociedades Anónimas* are valid and enforceable except (i) for liabilities arising from the commission of a crime or the willful misconduct of the Directors and the Officers, (ii) in the event of bankruptcy; provided, however, the liabilities of the Directors and the Officers did not legitimately benefit the *Sociedades Anónimas*, (iii) in case of specific legal provision whereby the economic burden of the liability must fall on the Directors or the Officers, or (iv) where expressly prohibited by applicable laws.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to Mexican law, *Sociedades Anónimas* are not subject to criminal liabilities; criminal liabilities are only applicable to individuals. The Directors and the Officers may be criminally liable for their own actions or omissions, carried either on their own behalf or on behalf of the *Sociedad Anónima*.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Pursuant to Mexican labour laws, labour relationship exist between the *Sociedad Anónima* (employer) and employees, therefore, companies shall be liable before employees. Notwithstanding the foregoing, Directors and Officers with functions of management or administration are considered to be the employer's representatives and will bind the *Sociedad Anónima* in their relationships with the employees. Therefore, Directors and Officers shall have to comply with the duties/liabilities of the *Sociedad Anónima* with regard to their employees.

Directors and Officers may be subject to personal liability for discrimination or sexual harassment or similar illegal behaviours.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Mexican insolvency laws provide that the Directors and Officers of the *Sociedades Anónimas* may be personally liable to restitute the bankruptcy estate in case of negligence, wilful misconduct or breach of law, only in those cases in which the corresponding bankruptcy is declared fraudulent. In this case, Directors and Officers shall also be personally liable for the payment of damages and loss of profit expectancies, in addition to any civil liability incurred, vis-á-vis, creditors of the *Sociedad Anónima*.

8. What remedies are available?

Legal and criminal actions against the Directors and Officers.

9. Who has the right to claim?

The *Sociedad Anónima*, third parties with a legal interest and liquidators have the right to initiate a judicial claim against Directors and Officers.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Pursuant to the Mexican laws, civil liability insurance is legal and may be purchased by the *Sociedad Anónima* or by the Directors and Officers.

11. Are there any corporate procedural prerequisites to effecting cover?

Mexican law does not provide any specific corporate procedural prerequisite to effecting cover.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Directors and Officers are bound to disclose to the insurance company all facts important to the risk assessment and all facts which might have an effect to the conditions agreed, as these are known or should be known at the time the contract is concluded.

13. Are there any tax implications connected to the purchase of D&O cover?

With the appropriate business and tax structure, Mexican corporations may take advantage of their insurance payments and translate them into deductions at least for Mexican income tax purposes.

In the case of non-employees directors, Mexican corporations may also analyze whether they qualify to take these expenses to reduce the Mexican business single rate tax.

As to the Mexican value-added tax, currently at a rate of 15%, Mexican corporations are entitled to credit the tax transferred by the Insurance Entities against its own value-added tax, which is regularly assumed as a cash flow issue, but not a cost at the Mexican corporation's level.

Lastly, in some circumstances Directors may alleviate the tax burden associated with the D&O insurance through the implementation of a tax equalization agreement.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

Pursuant to Mexican law, D&O insurance is not compulsory for *Sociedades Anónimas* or any other company.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

Pursuant to the Mexican Insurance Law (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*), civil liability insurance such as D&O Insurance Policy may not be contracted with foreign insurance companies to cover events that may occur within Mexican territory. In such cases in which the D&O insurance covers events that may occur within Mexican territory, D&O insurance must be contracted with Mexican insurance companies.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The beneficiaries of D&O insurance are generally the Directors and Officers and, in its case, the *Sociedad Anónima*.

17. What is commonly covered?

D&O insurance commonly covers the losses suffered by Directors and Officers or the *Sociedad Anónima* as a consequence of liabilities incurred by the respective Directors and Officers in their capacity as directors and officers of the *Sociedad Anónima*. In most cases cover will extent not only to the amount of any judgment or settlement reached as a consequence of any such liability incurred by the Directors and Officers, but also to other costs and expenses, such as legal or marketing advisors costs and expenses, incurred by the Directors and Officers or the *Sociedad Anónima* in defending the claims.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

D&O insurance generally exclude (i) any act in which the beneficiary may obtain an illegal benefit, (ii) any act derived from the intentional participation in an illegal act or felony, gross negligence and bad faith, (iii) property damages and personal damages, (iv) nuclear risk, (v) contamination, (vi) unauthorized benefits, (vii) intellectual property, (viii) donations, (ix) contractual liability, (x) war, terrorism risks, (xi) securities, (xii) labour liability.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Claims can be brought by the policyholder who would generally be the *Sociedad Anónima* or the Directors and Officers.

INDEMNIFICATION

20. Can the company indemnify its directors and officers? If so, for what?

Sociedades Anónimas may indemnify their respective Directors and Officers for any liability in which they may incur in their capacity as Directors and Officers of the *Sociedad Anónima*.

21. How is the indemnification dealt with in practice?

In practice, *Sociedades Anónimas* include in their by-laws the obligation to indemnify and keep harmless and in peace their Directors and Officers and assume any cost associated with the defense and payment of fines related to or arising from liabilities incurred by the Directors and Officers.

ANY OTHER BUSINESS

22. To what extent is corporate governance utilised to shield directors and officers?

Corporate governance shields Directors and Officers by setting forth principles and standards to which Directors and Officers shall be subject to and in case the Directors and Officers follow the respective principles and standards, their liability may be limited or they may even be released from liability by following such standards and principles.

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

To our knowledge, there are no anticipated legislative/regulatory changes to the extent of Directors' and Officers' liabilities, except for the current trend in changes to the legislation on regulated entities of the financial system in which liability of Directors and officers may be extended.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

To our knowledge, there are no anticipated legislative/regulatory changes to the legality of insurance cover/indemnification.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

The main areas to watch out in Mexico relate to the fact that most D&O insurance policies follow the wording of foreign D&O insurance and are issued by Mexican fronting companies to comply with Mexican law. As a consequence thereof, we encounter the usual problems associated with fronting, that is, inconsistencies of Mexican law with the insurance placed, language and translation issues, as well as control cause related problems and issues.

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[1] Mexican Law does not define a term which is comparable to that of an "officer" as we understand such term is used in U.S. legal practice. In fact, there are no specific titles which attach to specific functions of an individual within *Sociedades Anonimas*. Laws other than the General Law of Business Organizations tend not to be consistent in their terminology when attempting to define "officers". Be that as it may, the most typical scenario would be for *Sociedades Anonimas* to have a type echelon of individuals who are appointed a title by the Shareholders' Meeting or the Board of Directors and are expressly granted powers of attorney or corporate authority; these individuals would fall under all of the different terms we have found that attempt to cover the concept of *Sociedades Anonimas*' "officer". In view of the foregoing, wherever the term "officer" is used in this document it shall mean an individual who has received a title by the Shareholders' Meeting or the Board of Directors of *Sociedades Anonimas* and has been formally granted powers of attorney or corporate authority by that *Sociedad Anonima*.

[2] The concept of damages and profit expectancies (*daños y perjuicios*) under Mexican law comprises any detriment to the patrimony of claimant, as well as the loss of profit expectancies which would have been otherwise earned by such claimant. Mexican judicial policy and rules to award loss of profit expectancies are very restrictive; thus, loss of profit expectancies is seldom awarded.

[3] As a practical matter, *Sociedades Anónimas* rarely seek recovery of damages and loss of profit expectancies from the Directors and Officers; mostly claims of liability of the Directors arise from criminal complaints filed by the *Sociedades Anónimas*. The foregoing would be applicable to Officers.

[4] If no specific designation is made, the responsibility of carrying out shareholders' resolutions falls with the Chairmen of the Board of Directors of the *Sociedades Anónimas*.

Mexico 2

CARLOS RAMOS MIRANDA AND LUIS RODRIGO VELAZQUEZ - BARRERA, SIQUEIROS Y TORRES LANDA, S.C.

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Directors are considered to be those members to the board of Directors or board of managers of commercial or civil companies. These members have the overall responsibility of designing and implementing the strategic planning of the companies in furthering the corporate purpose of the company in which they serve. As a whole, the Board of Directors has the representation of the company (not each Director individually, but as an management body). If a company does not appoint a board of management, the position is filled by a Sole Director (Administrador Unico).

According to article 309 of the Code of Commerce (Código de Comercio, "C.Co."), Officers (known as "funcionarios", although legally known as "factores") are those who are in charge of the direction of a company or commercial establishment, and those that are authorized bind in name and representation of the company or commercial establishment, in all matters concerning to the underlying business.

Mexican law does not require mandatory appointment of Officers. Further, Mexican law does not recognize the concept of "implied authority" except under very specific cases[1]. Consequently, the determination on whether an individual is or not an Officer (factor) depends not only on the position of such individual but also on the fact that specific authority has been vested to him/her either by its position (under the corresponding by-laws) or by means of granting such individual general powers of attorney to bind the company.

Article 309 of the C.Co. regulates also other types of employees known as "dependientes" who act on behalf of the principal but only with respect to a specific trade within the company and whose authority to bind the company is limited. These individuals would not be normally considered as Officers.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Pursuant to article 10 of the General Law of Commercial Companies (Ley General de Sociedades Mercantiles, "LGSM"), the Directors of the company have the duty of the administration and representation of the company, to act within their powers and within the corporate purpose of the company.

The Directors have the responsibility to oversee the general management of the company, to establish policies fostering the corporate purpose of the company, which policies are to be implemented by the Officers of the company. The main duties/responsibilities of Directors are the following:

a) Remain in their duties until their successors have been appointed and taken office;

b) Ensure that the resolutions adopted by the Shareholders' Meetings are implemented;

c) Verify the reality of the contributions made by the shareholders to the capital stock;

d) Verify that all legal requirements are fulfilled before distributing dividends;

e) Verify the existence of all accounting, control of information systems, as well as those for recordal provided for in by law;

f) Notify the Statutory Auditor or Audit Committee of any irregularities in management incurred by those that may have preceded them in office;

g) Ensure that the legal reserve is created with the profits of each year, until such reserve is equivalent to 20% of the capital stock;[2]

h) Abstain from engaging in operations or actions after the end of duration of the company provided for in the by-laws, or after of dissolution of the company is resolved by the shareholders' meeting;

i) Prepare an annual report to the shareholders' meeting which shall include:

   i. A report on the business of the company;

   ii. A report with regard to the main policies used to prepare financial information;

   iii. A report showing the financial situation of the company;

   iv. A report showing the profits or losses of the company;

   v. A report showing financial changes in the company during the last fiscal year ended;

   vi. Any notes deemed necessary to clarify the foregoing information;

This annual report shall be submitted annually for approval by the shareholders' meeting, within the first four months following the end of each fiscal period.

j) Publish and Register before the Public Registry of Commerce, the annual report[3]

k) Abstain from participating in a decision in which they have a conflict of interest, and

l) Call general shareholders' meetings when needed, according to the by-laws and the LGSM.

In order to accomplish the corporate purpose of the Company, the Board of Directors and managers shall have those powers which are required to accomplish their responsibilities, except as otherwise provided under the law or the corresponding by-laws. For all practical

purposes, all authority conveyed to the Board of Directors is explicitly stated under the corresponding by-laws.

In this regard, Article 146 of the LGSM establishes that Officers shall have the powers which are expressly conferred upon them, if any, and will not need any special approval from the Board of Directors to carry out actions within the scope of their responsibilities, for which purpose they shall have the most ample powers to represent and take actions on behalf of the company. Notwithstanding this broad authority, as mentioned above, all Officers are deemed to be vested with the authority granted to them either by their position (under the corresponding by-laws) or by means of granting such individual general powers of attorney to bind the company.

An important distinction between Directors and Officers is that Directors are not considered employees of the company by virtue solely of their appointment as Directors,[4] while Officers are indeed considered employees of the company. Consequently, Officers' responsibilities and functions need to be carefully detailed in their employment agreements, and their authority also vested either through the granting of powers of attorney or under the company's by-laws.

Finally, specific rules apply regarding liability and responsibilities of publicly traded Companies in Mexico, under the Stock Market Law (Ley del Mercado de Valores). These obligations/responsibilities are even more stringent than those applying to Directors and Officers of non listed Companies. For instance, fiduciary and loyalty duties include the obligation to attend board meetings, disclosure of relevant information, confidentiality obligations, non intervention in the case of conflict of interests, and business opportunity standards.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Directors have a general obligation to ensure that the company actually engages in pursuing its corporate purpose. The Directors must act in the best interest of the company, and not necessarily of the shareholders, even in spite of the fact the Directors are appointed by the shareholders. Certainly, the Board of Directors is required to foster the value of the Company for the benefit of the shareholders, although this goal is reached by fostering the activities of the company itself. Te main obligations of Directors towards the shareholders may be summarized as follows:

a) Presentation of the financial statements of the company to the shareholders for their approval, as detailed under Section 2.i) above.[5]

b) Ensure that the resolutions adopted by the Shareholders' Meetings are implemented.[6]

c) Call general shareholders' meetings, when required by a statutory minority of shareholders, when required under the by-laws or under law.

d) Verify the existence of all accounting, control of information systems, as well as those for recordal provided for in by law. [7]

e) The Directors may be entrusted with establishing terms and dates for the payment of a dividend, but the dividend may only be declared by shareholders' meeting. [8]

f) Create special Committees required by the shareholders.[9]

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The LGSM establishes very limited instances where Directors and Officers would result liable vis-à-vis third parties.

Any Director or Officer that acts on behalf of a commercial company that has not been duly registered with the public registry of commerce shall be joint and severally liable for any such acts in the event that the Company does not honour the corresponding obligation.[10] Further, in the event a Director or Officer act in excess of their capacity or out of the scope of the corporate purpose of the Company (known as ultra vires acts) shall be personally liable for such actions. Further, in the case of fraud, those Directors and Officers involved would be personally liable.

In addition to the above, Mexican law establishes a joint and several liability on Directors, in the following instances:

a) The Directors are responsible if they do not create the legal reserve;[11]

b) The Directors of stock commercial companies are responsible of verifying that indeed shareholders honor their capital contributions.

c) Before paying any dividends, Directors must ensure that profits actually exist. Payment of dividends without the existence of profits results in personal responsibility for the Directors.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to article 26, section III of the Federal Fiscal Code, all persons in charge of the general direction, general management or sole administration of a company will be jointly responsible with the company for all taxes that were not retained or paid during the period in which they were in office. This responsibility will be only to the extent that the Company is not able to cover the omitted taxes and only in case (i) the company did not file for its taxpayers registry number; (ii) changes its domicile without providing notice to the authorities (in case an audit is underway); (iii) the company has no accounting or hides or destroys its accounting; or (iv) the tax domicile is abandoned without notice to the authorities.

Under article 388 of the Federal Criminal Code the Sate will prosecute any fraud committed by Directors and Officers..

Finally, under the Bankruptcy Law (Ley de Concursos Mercantiles) in the event that Directors and Officers of a company declared in bankruptcy willfully caused the cessation of compliance with obligations or that fail to deliver information requested by the court, will be prosecuted by the State.[12]

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors are not personally liable towards the employees in respect to labour obligations, since the relationship of the employees is directly with the company. However, Directors and Officers are responsible for implementing and adopting all measures necessary to comply with labour laws.

In Mexico, it is not uncommon for employees to sue not only the company but also the Directors and/or Officers with whom the employee had contact during the labour relationship. This poses an additional burden for the Company and the corresponding Directors and Officers to have the claim dismissed as it pertains to the Directors and Officers. Failure to defend such a case would result in a judgment adverse to such Directors' and/or Officer's interests.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In the case of bankruptcy, a special receivership would be appointed. Management of the Company is responsible for providing such person(s) all information requested by the court. Failure to provide such information may result in criminal prosecution. Further, as stated before, Directors and Officers of a company declared in bankruptcy that willfully caused the cessation of compliance with obligations or that fail to deliver information requested by the court, will be prosecuted by the State.

8. Who has the right to claim?

The right to claim liability from a Director or Officer resides primarily with the party whose interest has been affected.

In the event the Company has been affected by the alleged act, a claim against Directors may only be submitted when the general shareholders meeting approves and appoints a representative to file the claim. Should the shareholders meeting decide not to file a claim, shareholders representing 33% of the capital stock may file the claim directly provided the claim includes the whole interest of the Company and not only their personal interest, and provided further such shareholders voted in favour of pursuing the claim in the corresponding shareholders meeting. In the case of listed Companies, shareholders representing 5% of the capital stock may file the claim directly.

The rules for filing the claim may vary depending on the type of Company and its specific by-laws.

In the event the claim is to be filed against the Officers, the Company itself is to file the claim.

In the event third parties have been directly affected by alleged act, such third parties have the right to file the claim directly to the extent the law imposes a direct responsibility to the corresponding Director or Officer as described above.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

9. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Yes, the purchase of this kind of insurance is legal. Article 7 of the General Law of Insurance Institutions and Mutual Companies (the "Insurance Law") provides that the authorization given to a company to function as an insurance institution may refer to one or more of the insurance operations. Civil liability coverage is expressly

authorized in the case the authorization to the insurance company includes damages. The Insurance Contract Law specifically regulates the insurance on this type of coverage.

The law does not limit the ability for a third party to purchase the insurance, although it is generally purchased at the instruction of the Company itself, through its authorized representatives (Officers).

10. Are there any corporate procedural prerequisites to effecting cover?

There are no legal provisions requiring any special corporate procedural prerequisites, except, of course that the person requesting and signing the insurance has sufficient authority to bind the Company. Insurers may require the contracting of particular policies to be specifically approved either by the shareholders meeting or board of Directors.

11. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

(a) There is no legal provision mandating the Directors or Officers to provide any specific information to the Company or any organ of the Company prior to commencement of the cover. Certainly, any information that the Directors or Officers have, which may affect the acceptance of the coverage would need to be disclosed as part of their fiduciary duties.

(b) Articles 7, 8 and 9 of the Law of Insurance Contracts (Ley Sobre el Contrato de Seguro) provide that the insured must declare to the insurer all the relevant circumstances that are or should be of the knowledge of the insurance company in order to appropriately evaluate the risk. Any false declarations give the insurer the right to terminate the contract. Insurance companies request the Company to fill in a questionnaire which allows the appropriate evaluation of the risk. Any false or misleading information may result in the rescission of the cover.

12. Are there any tax implications connected to the purchase of D&O cover?

There are no special tax implications connected to the purchase of the D&O cover.

13. Is insurance of D&O exposures compulsory in respect of any type of company?

No, except mandated by the company's by-laws.

14. Is D&O insurance usually purchased locally or purchased from overseas markets?

D&O insurance must be purchased locally. Article 3 section II subsection 5) of the insurance law forbids the purchase of civil liability insurance for events that occur in Mexico with foreign insurance companies, unless a specific authorization is granted by the authorities when the specific product is not offered in Mexico.

THE EXTENT OF COVER

15. Who are the beneficiaries of the insurance?

While most policies only cover Directors, Officers, and high-level employees, some insurance companies also offer cover to the spouses of the insured and also to the company when there is a claim against the company for any violation to the securities laws.

16. What is commonly covered?

In broad terms, D&O insurance provide indemnity for the liabilities incurred unintentionally by the Directors and Officers, or the company as a result of their acting in the course of the business of the company and in performance of their duties. This commonly includes legal defence costs, investigation costs and damages and lost profits indemnity.

17. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Generally, exclusions will include any unlawful benefit, remuneration, profit or personal advantage obtained by the Officers and Directors, intentional acts, fines, administrative sanctions, taxes, violation of labour laws, personal injuries, and contamination. Each insurance policy has its own extended list of exclusions.

BRINGING A CLAIM UNDER THE INSURANCE

18. Who can bring a claim under the D&O cover?

The insured and the company.

19. What is the procedure for bringing a claim?

The insured and/or the company must notify the insurer of any claim or circumstance that may cause a damage or economic loss, within the next 15 calendar days from the date in which they had knowledge of such circumstance. Each individual policy may have specific requirements in terms of information and documentation to be provided along with the claim.

INDEMNIFICATION

20. Can the company indemnify its directors and officers? If so, for what?

Yes, Directors and Officers may be indemnified by resolution of the shareholders' meeting to the result of any action of a criminal, civil, administrative or investigative nature, if such action is a result of exercising his/her duties as a Director. It is becoming increasingly common for Company's by-laws to include specific obligation to indemnify Directors and Officers in case they are.

ANY OTHER BUSINESS

21. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No.

22. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

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[1] For instance, under article 85 of the General Law of Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito)*, Officers are considered to be authorized to issue negotiable instruments, solely by their appointment. Any limitations shall be included in the by-laws or powers of attorney granted to such individuals

[2] The legal reserve is a reserve that is required to be created by all commercial companies, consisting of 5% of the annual profits (provided they exist) until such time the legal reserve is equal to 20% of the capital stock of the company. See article 20 of the LGSM.

[3] The legal reserve is a reserve that is required to be created by all commercial companies, consisting of 5% of the annual profits (provided they exist) until such time the legal reserve is equal to 20% of the capital stock of the company. See article 20 of the LGSM.

[4] A Director may be also an employee of the Company (either an Officer or a simple employee). In these cases, it is important to distinguish in which capacity such Director acts on any given time.

[5] See Article 172 of the LGSM.

[6] See Article 159 section IV of the LGSM

[7] See Article 158 LGSM

[8] Dividends may only be paid out of net earnings as approved in financial statements approved by the annual ordinary shareholders' meeting.

[9] Listed companies are required to appoint specific compensation, investment, financial, audit and other committees.

[10] See Article 2 of the LGSM

[11] See Article 20 of the LGSM.

[12] Articles 271 through 273 of the bankruptcy law

Netherlands

DEBBY VAN DER LEEST, LOVELLS LLP

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

The Dutch Civil Code does not contain a definition on "Directors" and "Officers". Those (legal or natural) persons that are members of the body that manages the company and, because of that, (co-)determine the day-to-day policy of the Company are generally considered to be Directors and Officers. The directors have the obligation to discharge their obligations to the company properly.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The duties of Directors can be derived from Book 2 of the Dutch Civil Code and the articles of association of the company, and include amongst others keeping an administration and provide annual reports, organise shareholders meetings and registering the decisions of these meetings.

The liability of a Director to the company will be based on breach of contract (wanprestatie) due to a attibutable shortcoming (toerekenbare tekortkoming), as meant in section 6:74 of the Dutch Civil Code or because the director has failed to discharge his obligations properly, as meant in section 2:9 of the Civil Code.

There is an exeption to the liability of the Director in case the failure to discharge his obligations properly cannot be attributed to such Director and the Director has undertaken actions to prevent the negative consequences related to this disfunctioning.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Supreme Court in the Netherlands (de Hoge Raad, LJN: BC4959, HR , C06/187HR) recently ruled that there is a liability for Directors to shareholders in the event the Director can be held accountable for an action with which it has failed to observe its duty personally and severe (persoonlijk en ernstig verwijt). The answer to this question has to be decided on a case-to-case basis.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Principle rule under Dutch law is that Directors are excluded from liability towards third parties for agreements that the company has entered into. However, various exceptions to this rule apply. Pursuant to Dutch law a Director of a company is (amongst others) considered to be personally liable:

- for all legal acts entered into by the company prior to the registration of the company in the Trade register;
- in case of personal and severe failure by the Director to observe his duty; and
- in case the annual accounts are misrepresenting.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

A Director can be held accountable for criminal actions in case the company violates a stipulation from the Criminal Code or the Act on Economic Offenses (section 51 Criminal Code).

A Director can be accountable for breach of regulatory provisions. This may lead to a negative judgement on his trustworthiness and if that is the case, that specific Director will need to resign and may not become a Director with another financial institution for the next eight years (or less depending on the severeness of the provision that has been violated). There is a bill that deals with the possibility to impose an administrative fine to the Director of the company, for an act of the company itself.

A Director can also be held liable in person for taxes that are due by the companies that are left unpaid.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The relationship between a company and its employees is largely governed by the employment contract, and the

ARBO-Act. There is no specific provision which gives an employee a direct right against a Director. It is doubtful whether employees could personally sue a Director for a claim arising from the Director's conduct.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The Insolvency Act (Faillissementswet) read in conjunction with section 2:248 of the Civil Code allows a duly appointed administrator/liquidator to investigate the affairs of the company including the conduct of the Directors. An administrator or liquidator, who believes the Directors failed to discharge their obligations, and thereby contributed to the company's failure, may institute action against the Directors to recover the debts of the company from the Director personally.

In addition to the above any Director and Officer may be held liable by a liquidator (for the whole deficit in the estate) on the basis of section 2:248 subsection 2 of the Dutch Civil Code, in case the annual accounts of the company have not been published in time (i.e. within 13 months after the ending of the financial year).

8. What remedies are available?

Awards of damages, recovering debts of the company from the Director, fines, imprisonment.

9. Who has the right to claim?

Depending on the circumstances, the company, shareholders, third parties, liquidators and, in the context of criminal matters, the State has the right to claim, in the regulatory context, the Supervising authority may insist that the Director resigns.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of D&O insurance cover is legal. A company is ordinarily the purchaser of the policy. The policy extends cover to Directors, Officers and certain categories of employees.

11. Are there any corporate procedural prerequisites to effecting cover?

A board resolution is required.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

The potential insured is required to give disclosure to the insurance company of all facts known to the insured which are material to the risk and of which it is reasonable to assume that the insurer will want to take into account in determining whether or not to provide cover.

***13. Are there any tax implications connected to the purchase* of D&O cover?**

There is no taxable benefit for the Directors and Officers of the company, since the company is the one that enters into a contract with the insurance company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

D&O cover is not compulsory.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

If insurance is purchased, it is locally or from an insurer based in a country other than The Netherlands. We do not have any figures on the re-insurance of the risks from policies entered into, but it is most definite like that the insurance companies re-insure the risks. In The Netherlands there is a so-called BCA-policy, and the offerers of these policies have pooled the risks to the extent that they bear the risks of these policies together.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

Possible beneficiaries of the policy are directors, persons that co-decide the policy of the company, members of the Supervisory Board (current and former), spouses, and heirs of the beneficiaries (in case a claim against them arises from a claim against a beneficiary that has passed away).

17. What is commonly covered?

It provides indemnity for liabilities incurred by Directors and Officers as a result of their acting in the course of the business of the company. In most cases cover will extend not only to the amount of any judgement or settlement, but also to the legal and certain other costs incurred by the insured individual in defending claims.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

The policy shall not provide indemnity for damages that has been caused intentionally by the beneficiary. Also no indemnity will be provided in case the beneficiary caused an offense against property (vermogensdelict). Imposed fines, penal sums, or similar payments with a punitive or enforceable character.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

The policyholder can bring a claim under the cover.

20. What is the procedure for bringing a claim?

A claim is brought to the insurance company by notification of the possible claim.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Yes.

Directors and Officers are generally discharged for their duties at the time the annual accounts of the company are approved by the shareholder. Upon discharging a Director or Officer, such Director or Officer cannot be held liable anymore by the company and/or its liquidator (in case of bankruptcy) on the basis of art. 2:9 of the Dutch Civil Code. Do note that this does not mean that such Director or Officer cannot be held liable anymore by third parties. A resolution from the shareholder to discharge the Directors for the management performed by such Directors has only internal effect.

Directors and Officers may also be indemnified (on a contractual basis) by either the company, a shareholder or any other person.

22. How is the indemnification dealt with in practice?

Under Dutch law an indemnification is often dealt with on the basis of a separate agreement between the Directors or Officers and the indemnifying entity or person.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

In The Netherlands there is a Code which deals with corporate governance (Code Tabaksblat). But the purpose of that Code is not so much to shield Directors and Officers, but to provide transparency, more accountability to the supervisory board, and to strengthen the rights and the control of shareholders.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

Not at this stage.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

Not at this stage.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

D&O policies are most often entered into by the company. Coverage under the policy is most often dependent on whether or not the insurance premiums have been paid. It sometimes happens that the company – due to financial difficulties – is not able to pay the premiums and – due to the same financial difficulties – enters into bankruptcy.

Should the court-appointed liquidator then decide to hold the Directors and/or Officers liable for the whole deficit in the estate (based on of the grounds for director's liabilities), the Directors and/of Officers run the risk of not being able to claim under the D&O policy.

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Peru

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

In accordance with article 152º of the General Corporate Law, the administration of the corporation is in charge of the Board of Directors and the General Manager. Only closely held corporations ("*sociedades anónimas cerradas*") can exist without a Board of Directors, in which case all attributions and capacities of the Board as well as responsibilities thereto are vested on the general manager.

In this regard, being in charge of the corporate administration, direction and management of the company, the members of the Board of Directors and the general manager and other high ranked managers are considered to be responsible Directors and Officers.

Additionally, the insurance policies taken out in the Peruvian market, consider like directors and managers those individuals who develop senior management roles under the direct leadership of the administrative authority, executive commissions or company advisers, as well as legal representatives, high officers, among others. On the contrary, auditors, custodians, supervisors or administrators do not have that capacity.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Duties/liabilities of the managers

General approach

Broadly, pursuant to article 171° of the General Corporate Law, directors must conduct themselves with the diligence of an "orderly merchant" and of a "loyal representative". Thus, they are subject to a duty of care and loyalty. Although those terms are not defined in the law, they point to a careful and professional exercise of the office, performing their activities in view of the interests of the company, rather than particular interests.

Specific duties/liabilities

Specifically, pursuant to article 177° of the General Corporate Law, the directors are unlimited, jointly and severally liable to the company, the shareholders or third parties for damages caused due to resolutions taken or acts conducted in contravention of the law or the by-laws or in which they acted with "dolus" (willful misconduct), abuse of powers or capacities or gross negligence.

Directors are jointly and severally liable with those who preceded them for the irregularities committed by the latter if, being known to the directors, they do not inform them in writing to the shareholders meeting.

Duties/liabilities of the managers

General approach

The same standard of behaviour and responsibility applicable to the members of the board set forth in 2.1 above should rule the performance of the managers.

Specific duties/liabilities

Specifically, pursuant to article 190° of the General Corporate Law, the managers are responsible for their acts conducted in contravention of the law or the by-laws or in which they acted with "dolus" (willful misconduct), abuse of powers or capacities or gross negligence, causing damage to the company, the shareholders or third parties. Particularly, they are responsible for: (i) the existence, regularity and truthfulness of the accounting books and records of the company; (ii) the creation and maintenance of an internal control structure designed to provide a reasonable security that the assets are protected against non authorized use and that all transactions are performed in accordance with the authorizations therefore granted and are duly registered; (iii) the truthfulness of the information provided to the Board of Directors and to the Shareholders' Meeting; (iv) the hiding of irregularities noticed in the activities of the company; (v) the preservation of the funds belonging to the company; (vi) the use of the corporate funds in activities that differ from those comprised in the corporate object; (vii) the truthfulness of the certifications and evidences issued in respect to the content of the company's books and records; (viii) provide the shareholders with the relevant information referred to the issues to be discussed in shareholders meetings; and (ix) the compliance with the laws, the bylaws and the resolutions passed by the Shareholders' Meetings and Board Meetings.

The general manager in jointly and severally liable with the board members, when participating in acts for which the directors are liable or when knowing of said acts, does not report them to the board or to the shareholders meeting.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Please see section 2. A director will not be responsible if having participated in the resolution or having knowledge of it, expresses his disagreement at the time when the resolution is passed or when the director had knowledge of it; provided that such disagreement is stated for the record in the minutes of the board meeting of by letter sent through notary public.

Directors´ liability will be time barred after two years of the date when the board resolution was passed or when the act that originated the damage was performed. The same time limit applies to the managers.

Legal action by the company against Directors requires the previous resolution passed by the shareholders meeting

deciding to initiate liability action. In certain cases, shareholders representing one third of the stock capital can file the liability action. Damages awarded in said action belong to the company and not to the shareholders, who are entitled to reimbursement of legal costs.

Creditors of the company, which credits are gravely threatened by the wrongful acts, can file liability action against the directors directly, provided that said actions aim at reconstituting the company's net worth and that the company or its shareholders have not filed the liability action.

Liability action against managers is decided by the shareholders or by the board of directors, and provisions on directors´ liability applies to managers.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

If individual interest of a shareholder or of third parties is directly damaged by wrongful acts of the directors, the aggrieved party is entitled to file an action for damages against the directors. Damages caused to the company implying a consequential damage to the shareholder or third party is not considered direct damage.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Criminal liability

In this regard, it is important to stress out that one same act can trigger not only civil liability but also criminal liability for the directors and managers, provided the specific elements of a crime foreseen under Peruvian law are met.

The criminal liability can exist with regard to the company, the shareholders and third parties. But a director or a manager could also be made liable of a crime in cases in which the company committed crimes acting on behalf of the director, due to the fact that the company can never be made criminally liable due to its condition of legal entity.

The statute of limitations of two years civil liability of the directors and managers is not applicable to criminal liability. The general rule in the Penal Code is that criminal action expires in a term equivalent to the maximum period legally foreseen as penalty for the relevant crime.

Tax liability

With regard to the obligations of the company towards the Peruvian tax authority, there are certain characteristics that must be mentioned. Pursuant to article 16° of the Tax Code, the representatives appointed by legal entities (directors, managers and other representatives) are bound to pay taxes and comply with the formal tax obligations of such entities with the resources they manage or that they have.

In this sense, the aforementioned rule sets forth that joint and several liabilities will exist between the company and its representative when by fraud, gross negligence or abuse of faculties, the payment of tax debts is omitted.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are not special regulations in this regard. Hence, employees should be considered as simple third parties in relation to the duties/liability that directors or managers can take against them.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are no specific provisions in order to establish civil liability of directors or managers to administrators or liquidators in cases of bankruptcy.

Nevertheless, article 83.2 of the General Bankruptcy Law sets forth that it is a function of the liquidator to file criminal complaints before the relevant Public Prosecutor's Office if it is verified the existence of elements that suggest the commission of fraudulent acts in the administration of the company.

8. What remedies are available?

The liability set forth in the General Corporate Law has to be determined in a judicial (or arbitral) proceeding. If the damage and its direct relation with the acts of the director or manager (contravention of laws and bylaws, willful misconduct, abuse of faculties or gross negligence) are proven, the judge or arbitrator will award the amount of damages and will order payment accordingly.

The directors could be subject to the same two kinds of liability claims to which the managers could be subject: (i) liability claims started by the company (or by its shareholders or creditors, under certain conditions) due to damages caused by the directors or managers to the

company; and (ii) liability claims issued by the shareholders or third parties for acts of the directors or managers that directly damage the interests of the claimants.

9. Who has the right to claim?

As mentioned, the company, shareholders, creditors and third parties have the right to claim civil liability to Directors and Officers in Peru.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Yes. As per Article 429 of the Code of Commerce, other kinds of insurance risks can be established, provided that they are lawful and conform to the general rules in the code. D&O policies fit within said provision, since there are no specific provisions of law applicable to D&O insurance. There are no specific restrictions in the law as to who the contracting party or the insured can be.

11. Are there any corporate procedural prerequisites to effecting cover?

There is no special procedure to be complied by the company wanting to hire D&O insurance. General insurance rules will apply.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

As a general rule, the insurance contract must be entered into and performed according to the rules of good faith, which requires the insured providing accurate and relevant disclosure and statements of facts or circumstances which may influence in the assessment of the risks. The omission or hiding of relevant information of facts or circumstances that could influence in the decision to provide coverage will void the contract of insurance.

In practice, Peruvian insurance companies require the filling of questionnaires and furnish of relevant information by way of statements provided by the insured. The policy usually states that that said statement is the essential ground for the acceptance of the risks.

13. Are there any tax implications connected to the purchase of D&O cover?

No, there aren't. Value added tax of 19% is assessed on insurance premium.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No.

THE EXTENT OF COVER

15. Who are the beneficiaries of the insurance?

According to the practice in the local market, the directors, managers, counselors and legal representatives can be beneficiaries. In some cases, the spouses and heirs of the principal insured can also be beneficiaries whenever they are affected with the complaint that is within range.

16. What is commonly covered?

It is covered the Directors´ and managers' legal liabilities for any damage against third party caused by their negligent acts or omissions. Negligent act can be any failure in performance of duties, incorrect statements, omissions, negligence or gross negligence resulting in the exercise of their functions or in their relationship with internal staff or third parties. The cover extends to expenses and costs of defence.

17. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

In common practice, D & O policies in Peru exclude coverage in the event of intentional violation of a legal provision or of the commission of a criminal offense; fines or penalties imposed on directors and managers; damages arising from injuries to individuals or property damage, pollution damages, among others.

BRINGING A CLAIM UNDER THE INSURANCE

18. Who can bring a claim under the D&O cover?

The insured or the company beneficiaries as appropriate can claim the insurance. Third parties being harmed by directors and officers can file direct legal action as well, since the insurer is jointly and legally liable with the insured for the damages caused by the latter.

19. What is the procedure for bringing a claim?

Usually, insurance policies establish that insured, beneficiaries or the company must report the claim to the insurer between 3 and 15 days following the date that they have known the cause giving rise to cover. In some cases, late notice of the claim may bring along prejudice to the insurer, in which case there would be a chance to compensate such prejudice from the indemnification amount. Late notice per se would not allow insurer to void the policy.

However, the Company and the insured must deploy adequate defences from the time they take knowledge of any potential claim.

INDEMNIFICATION

20. Can the company indemnify its directors and officers? If so, for what?

There is no legal restriction for the company to compensate its directors and managers. Usually, the insurance companies in their policies establish the recognition of such compensation, and their coverage, discounting the deductible. The indemnification would compensate in full extent the director or officer's liability exposure.

21. How is the indemnification dealt with in practice?

See 20.

ANY OTHER BUSINESS

22. To what extent is corporate governance utilised to shield directors and officers?

In 2002, the National Supervisory Commission for Companies and Stock - CONASEV published "Principles of Good Government for Peruvian Corporations". These guidelines are being followed by most companies listed in the stock exchange. While there are no mechanisms to protect the directors and managers, these recommendations raise the need for all necessary facilities to performing their duties.

23. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No there are not.

24. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No there are not.

25. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

No there are not.

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South Africa

ROB OTTY, DENEYS REITZ INC.

Form and nature of liabilities to which corporate representatvies are exposed

1. Who are considered to be responsible directors and officers?

The Companies Act, 1973 ("the Act") defines a director as including any person occupying the position of a director or alternate director of a company, by whatever name they may be designated.

Section 210 of the Act requires that the appointment of directors shall be voted on individually at a general meeting of the company. Any person appointed as a director must furnish a written consent to such appointment. Section 214 of the Act states that the acts of a director are valid notwithstanding any defect that may afterwards be discovered in the appointment or qualification.

Persons who are disqualified from acting as directors include an unrehabilitated insolvent, a person removed from an office of trust on account of misconduct or a person who has at any time been convicted of theft, fraud, forgery or uttering a forged document.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In terms of the South African common law directors have a fiduciary relationship with the company. They may not exceed their powers, exercise their powers for an improper or collateral purpose or personal gain, fetter their discretion or place themselves in a situation which creates a personal conflict of interests.

The Act contains similar provisions. The Act imposes diverse duties on directors. Some are enforced by criminal sanction, and some sections expressly provide for civil liability. A director may not use the position to gain any personal advantage or to gain advantage for a person other than the company. A director carries out duties with the degree of care, skill and diligence that may be reasonably expected of a person carrying out the same functions in relation to the company.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

A director does not owe fiduciary duties directly to individual shareholders. Such duties are owed to the company. Certain sections of the Act such as Section 424 permit shareholders (and other third parties) in some instances to prosecute claims against the directors in their personal capacities. If the directors have conducted the affairs of the company recklessly or fraudulently, they may be personally liable to third parties, including shareholders, for the debts of the company.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are various exceptions to the general rule that the directors and officers of a company are not liable for its debts. One such exception is if the directors are found to have acted recklessly or fraudulently. Another exception is if a director were to sign a bill of exchange, promissory note, cheque or similar on which the name of the company is not mentioned in legible characters, the director will be liable to the holder of such instrument unless it is duly paid by the company. If directors act beyond their authority, thereby breaching their warranty of authority, and this was unknown to the third party, they may be liable to the third party if the company does not ratify such breach.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In terms of Section 424(3) of the Companies Act, 1973, a person who is knowingly a party to the reckless carrying on of the business of the company is guilty of an offence. In order to secure a conviction the State must prove that the business was carried on recklessly or with the intention to defraud creditors. There are other examples of legislation which may create criminal liability for directors such as the Occupational Health and Safety Act which imposes criminal liability on a director in circumstances where a person has been injured or killed as a result of an industrial accident or similar. There are amendments to the Competition Act which will also impose criminal liability on directors for the company's anti-competitive behaviour.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The relationship between a company and its employees is largely governed by the Labour Relations Act and its related regulations. There is no specific provision which gives an employee a direct right against a director. It is doubtful whether employees could personally sue a director for a claim arising from the director's conduct.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In South Africa the term used is "insolvency". The Companies Act and Insolvency Act allow a duly appointed liquidator to investigate the affairs of the company including the conduct of the directors. A liquidator, who believes the directors acted reckless or fraudulently, and thereby contributed to the company's failure, may institute action against the directors in terms of the relevant provisions of the Companies Act to recover the debts of the company from the director personally.

8. What remedies are available?

In the civil context, if directors are found to be personally liable for losses caused by their conduct, they may be ordered to pay damages. In certain instances such as the quoted example of the Occupational Health & Safety Act, directors may be criminally convicted and ordered to pay a fine. They may also serve a period of imprisonment if their conduct constitutes an offence either in terms of the common law, or in terms of applicable legislation.

9. Who has the right to claim?

Depending on the circumstances, the company, shareholders, third parties, liquidators and, in the context of criminal matters, the State have the right to claim.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of D&O insurance cover is legal. A company is ordinarily the purchaser of the policy. The policy extends cover to directors, officers and certain categories of employees.

11. Are there any corporate procedural prerequisites to effecting cover?

A Board Resolution will suffice.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Disclosure of all material facts must be made to insurers prior to inception of the policy. Such information would include external directorships, criminal convictions, previous civil claims against the company and directors and any information which may suggest the fact of a potential claim. All information material to the risk and the assessment of the premium, must be disclosed to the insurer.

13. Are there any tax implications connected to the purchase of D&O cover?

Since the company is the policy owner, the purchase of D&O cover is not regarded in South African law as a taxable benefit for the directors and officers of a company. It is a deductible by the company as a company expense. It is not taxed as an employer benefit.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

There are only a few insurers in South Africa that provide D&O cover. Lloyds of London operates in the SA market. Companies may purchase locally or from the overseas markets. Depending on the extent of the cover purchased, it is most likely that at least a portion of the reinsurance protection will be obtained from the overseas market.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The individual directors and officers of the company, and, in certain instances, specified categories of employees. Company reimbursement cover may also be purchased.

17. What is commonly covered?

Claims arising during the policy period from any wrongful act by directors acting in their capacity as such. Ordinarily if the company has indemnified the particular director, cover for that director is excluded. The costs of defending a claim, including the claimant's costs, also usually form part of the indemnity.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Fines, penalties, punitive damages and claims arising from the director's fraudulent conduct or conduct which is designed to secure personal profit or advantage. Ordinarily claims by the company or another director are also excluded. Claims arising from the director's duties imposed by the Employee Retirement Income Security Act of 1974 (USA) or the Pensions Act 1995 (UK) are also ordinarily excluded in terms of policies issued by local insurers.

INDEMNIFICATION

19. Can the company indemnify its directors and officers? If so, for what?

Section 247 of the Act prohibits the company, whether by way of its Articles or by way of contract, from exempting any director, officer or the auditor of the company from any liability which by law would otherwise attach in respect of any negligence, default, breach of duty or breach of trust for which the director may be guilty in relation to the company. The company may furthermore, not indemnify the director against any such liability. Any provision to the contrary, is void.

The provisions of Section 247 do not, however, prohibit a company from indemnifying a director or officer in respect of any liability incurred in defending any proceedings, whether civil or criminal, in which judgment is given in the director's favour or acquitted or in respect of any proceedings which are abandoned.

In terms of Section 248 of the Act a Court has the discretion to relieve a director, either wholly or in part, from liability even where the director may have acted negligently, in default, or in breach of duty. A Court exercises this discretion in favour of a director if it believes that the director has acted honestly and reasonably and that, having regard to all the circumstances of the case, the director ought fairly to be excused from negligent or wrongful conduct. If a director believes that a claim may be made against him or her in respect of negligence or default, he or she may, in terms of Section 248, apply to Court for relief provided for in the section.

A proviso to Section 247 (which prohibits a company from exempting a director from liability) is that the section does not apply to D&O insurance taken out by the company as indemnification against any liability of any director or officer towards the company in respect of any negligence, default or breach of duty.

ANY OTHER BUSINESS

20. To what extent is corporate governance utilised to shield directors and officers?

In South Africa companies listed on the Johannesburg Securities Exchange are obliged to conform not only to the Act but also the King II Code of Corporate Governance. This Code sets out a framework to assist directors to ensure proper corporate governance. The Code is currently under revision and King III is expected.

In reality the conduct of a director is in each particular case measured against the duties and obligations imposed by the common law, the Act and, in the instance of listed entities, by King II.

21. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

Company law in South Africa is currently undergoing substantive revision. There have been amendments to the Companies Act. Further amendments are expected. The Companies Act, 2008, is due to be promulgated shortly. This Act shall have an effect on the rights and duties of directors (both executive and non-executive). It also contains provisions which deal with the ability of a company to indemnify its directors. The new Act will undoubtedly have some relevance to D&O insurance in South Africa.

22. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

Not at this stage.

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Spain 1

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

The definition "Directors and Officers" include a wide range of persons that fall into the D&O liability coverage.

Firstly, the D&O liability coverage include the members of the Board of Director or Directors (known as *administradores* or *consejeros* in Spanish) and the Officers (those persons appointed by the Board of Directors to carry out executive functions)

According to scholars, shadow directors do not fall into the definition of directors covered by the insurance whereas *de facto* directors (persons who are not *de jure* directors but perform the acts or duties of a director) do fall into it.

Moreover, the D&O liability coverage sometimes include, apart from the directors and officers of the policyholder, the directors and officers of its subsidiaries, the officers of its branches and even the legal representatives of the policyholder in those companies which are participated by such policyholder.

In some cases, other persons such as the Counsel of the policyholder are also included in the coverage.

In conclusion, the D&O insurance is interpreted very widely in Spain.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Firstly, it must be highlighted that the duties/liabilities of the directors and officers are regulated under the *Ley de Sociedades Anónimas or LSA*. Although this Act regulates limited liability companies, some of its provisions are also applicable to other type of companies.

The duties of the directors are set out both in the LSA and in the Articles of Association of the company. The duties/liabilities of the Board of directors are to represent the company towards third parties, to manage the company, to convene the General Meetings and to enforce the decisions taken by the Shareholders. Taking into consideration that the Board of Directors is a collegiate body and that, therefore, it is sometimes difficult to take decisions, some of the executive functions of the Board of Directors are delegated to Officers.

Moreover, directors owe the following duties:

- Duty of diligent management: directors are required to perform the job with the diligence of an orderly entrepreneur and a loyal representative
- Duty of loyalty: the director must not take personal advantage of the company.
- Duty of care: directors must comply with any duties imposed by the law and the Articles of Association in the interest of the company.
- Duty of confidentiality: directors must keep secret all information that may have a confidential nature even after ceasing as directors.

Liability:

134 LSA establishes that if the directors cause any harm to the company, the board of shareholders (on behalf of the company) or the company's creditors are entitled to bring a corporate liability action called *acción social* against the directors.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors also owe duties directly to individual shareholders. Therefore, article 135 LSA grants individual shareholders to prosecute claims against those directors that act against the shareholder's interests. In other words, if the directors act recklessly or fraudulently harming a particular shareholder, such shareholder is entitled to bring an individual liability action against the directors (*acción individual*).

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors owe duties to third parties. Therefore, when a director -when acting as such- acts or fails to act personally (not on behalf of the company) in such a way it causes damages to a third party, the third party is entitled to prosecute claims against the director as per article 135 LSA (*acción individual*).

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Criminal

On the one hand, the Criminal Code sets out a list of corporate crimes that might be committed directly by

directors in articles 290 to 297, i.e. falsifying the company's documents (article 290), abuse of a dominant position (article 291 and 292), stopping the shareholders from exercising their rights (article 293).

On the other hand, the Criminal Code sets out a list of crimes that are committed by the company itself (using the company as a vehicle) but as an entity cannot be held criminally liable, the directors and officers would be held liable for such crimes. These crimes are, among others, the following: punishable insolvency, crimes related to intellectual property, money laundering, etc.

Obviously, the criminal liability is not covered by the D&O policies. As for the civil liability that derives from the crimes, it is only covered by the D&O policy when the crime has been committed negligently, and not on purpose (wilful misconduct)

Regulatory

There are many sectors that have their own and specific regulation, such as the stock market or the insurance market. The companies that operate in the stock market must necessarily comply with the provisions of the Stock Market Act (*Ley de Mercado de Valores*), whereas insurers, reinsurers and intermediaries must comply with the Consolidated Act on the Regulation and Supervision of Private Insurance Activity (*Texto Refundido de la Ley de Ordenación y Supervisión de los Seguros Privados*) These Acts provide for the different infringements that may be committed and the sanctions that may be imposed to both the companies and their directors and officers.

It must be highlighted that fines -one of the most typical sanctions that might be imposed as per the abovementioned Acts- must be excluded in the D&O cover. In fact, the Spanish Insurance regulator (DGSFP) issued a Criteria (an answer to a question made by professionals which is supposed to be binding on all insurers, reinsurers and mediators) on 31 March 2009 saying that the cover of fines is not compatible with our legal system.

Tax

When a company fails to comply with its tax obligations, the Tax Authorities must first seek collection of taxes from the company. Nevertheless, Tax Authorities might provisionally seize assets of the directors in order to ensure the collection of taxes while the investigation process is being carried out. In certain cases, directors might be held jointly and severally liable with the company: i.e. when the director willingly causes or collaborates actively in the transfer or hiding of the company's assets to hamper or prevent the collection of taxes

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under Spanish Law, there is no specific provision which grants an employee a direct right against a director of the company. It is the company itself who is held liable for the infringement of its labour and social security/welfare obligations towards its employees.

However, the company might then bring a claim against the particular director who has acted recklessly. In such case, the director's liability could fall into the cover of his D&O policy.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In Spain the term used for bankruptcy is concurso de acreedores and it is regulated under *Ley 22/2003, Concursal* (Insolvency Act). In certain cases, the directors of a company might be held liable for the insolvency. Such liability can be covered by the D&O policy underwritten, provided that the directors have not acted with bad faith or fraud.

8. What remedies are available?

In the civil context, if directors are found to be personally liable for losses caused by their conduct, they may be ordered to pay damages. In some cases, directors may be criminally convicted and ordered to pay a fine. They may also serve a period of imprisonment if their conduct constitutes an offence.

9. Who has the right to claim?

Depending on the circumstances, the company, shareholders, third prejudiced parties and, in the context of criminal matters, the State has the right to claim.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of D&O insurance cover is legal. The purchaser of the policy is usually the company, but it may also be the insured itself (the director or officer). The policy extends covers to directors, officers and certain categories of employees, as explained in our first answer.

11. Are there any corporate procedural prerequisites to effecting cover?

No.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Prior to commencement of cover, the policyholder must answer to a questionnaire provided by the insurer. The policyholder is not obliged to answer to questions other than those contained in the questionnaire (that is the reason why is so important for an insurer to issue a detailed questionnaire).

The insurer requests financial information, accounting information, commercial aspects, if there have been any previous claims against the company or the directors and officers and any other information which may suggest the fact of a potential claim.

13. Are there any tax implications connected to the purchase of D&O cover?

Yes, there are.

If the policyholder is the company, the premium paid is deemed to be a deductible expense.

As for the tax implications regarding the directors and officers, the question is not very clear.

According to article 42.2 (e) of the the Personal Income Tax Act (*Ley 35/2006, del Impuesto sobre la Renta de las Personas Físicas*), premiums paid by employers for civil liability policies in which its employees are the insureds cannot be considered a benefit in kind for them. Taking into consideration that officers are considered workers/employees of the company (special labour relationship) as per Spanish Law, the premium paid by the company for the D&O coverage is not deemed to be a benefit in kind.

As for directors, their relationship with the company is not that of a worker or an employee. Therefore, the premium paid by the company would be a benefit in kind subject to personal taxation.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

There are many insurers in Spain that provide D&O cover. In 2005, there were 26 Spanish insurers that provided D&O and the number has increased considerably since then. As for the reinsurance, it is common to obtain protection from an overseas market. In fact, there are only two Spanish reinsurers.

THE EXTENT OF COVER

16. What is commonly covered?

Claims arising during the policy period from any wrongful act (contrary to the law, to the Articles of Association or to their general duties) by directors and officers acting in their capacity as such.

Most of the D&O policies include a "claims made clause", which means that only those losses claimed within the term of the contract fall into the cover.

17. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Some of the typical exclusions are the following:

(a) Fines, penalties and other sanctions (i.e. administrative and tax sanctions); for the reasons explained above.

(b) Liability arising from the director or officer's fraudulent and bad faith conduct.

(c) Damages other than economical damages (for instance, corporal or moral damages)

(d) Liability deriving from faulty products, nuclear risks (as these risks are usually covered by other insurances) and war (as directors and officers cannot be held liable for war)

(e) Damages derived from the Euro period (transition from the peseta -former currency- to the euro)

(f) Claims that refer to any wrongful act by directors or officers when they are not strictly acting as such.

BRINGING A CLAIM UNDER THE INSURANCE

18. What is the procedure for bringing a claim?

Both the insureds or any third party affected by the director or officer's act or omission.

Firstly, it must be pointed out that according to article 76 of the Spanish Insurance Contract Act (*Ley 50/1980, de Contrato de Seguro*), the insured (in this case, the director or officer) must necessarily communicate the prejudiced party the name of its insurer, if any.

The prejudiced party can bring a direct action against the D&O insurer from the moment the harm is caused (or discovered), under article 76 of the Insurance Contract Act. There is no need to wait until the Court pass a sentence convicting the director or officer, or until there is a debt recognition between both the insurer and the insured, as it happens in the USA.

Consequently, the prejudiced party is entitled to bring an action against the insurer, or against the insurer together with the insured. If the prejudiced party decides to sue only the insured director or officer, this latter must necessarily inform its insurer.

INDEMNIFICATION

19. Can the company indemnify its directors and officers? If so, for what?

Under Spanish Law, liability can be neither contractually excluded nor limited in the event of intentional acts -wilful misconduct- (*dolo*) or gross negligence, whereas it can be contractually limited in the event of negligent acts.

Notwithstanding the above, even if the limitation (partial exclusion) or exclusion of liability for negligence is valid, in case of dispute there is a theoretical risk of the clause being moderated by the court if, based on particular circumstances, the limitation is considered unfair or disproportionate.

In light of the aforesaid, a contract whereby a company agrees to indemnify or hold harmless a director from any liabilities deriving from fault or negligence would be valid in respect of personal claims brought by individual shareholders or prejudiced third parties.

On the contrary, the question is less clear regarding corporate liability action (*acción social*), established in article 134 LSA. An indemnification agreement stipulated in the Articles of Association for those cases in which the corporate action is brought against the director would be null and void, as the company would be both the creditor and the debtor.

Nevertheless, the shareholders would always be able to decide, assembled in meeting, not to bring the abovementioned corporate liability action or may waive it (except in cases of wilful misconduct), provided that shareholders representing at least 5% of the share capital did not oppose to such waiver.

As for officers, an indemnification agreement established in the Articles of Association is perfectly valid (except in cases of wilful misconduct).

20. How is the indemnification dealt with in practice?

Companies may indemnify their directors to the fullest extent permissible in law.

ANY OTHER BUSINESS

21. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No.

22. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

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Spain 2

JORGE ANGELL, L.C. RODRIGO ABOGADOS

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Directors or administrators are individuals (or companies) appointed by the shareholders to manage the company. There are several admitted forms of management organization:

- Board of Directors, with a minimum of three members;
- Single or Sole Director;
- Two joint Directors acting together;
- Two or more Directors acting individually.

Companies may also be appointed but they must in turn appoint an individual to carry out the management functions.

This definition is extended to non-executive directors and to those who in fact effectively manage the company without having been formally appointed as directors, i.e., the so called "*de facto*" directors (which are not exactly "shadow" directors).

Further, a distinction should be made between directors and officers at corporate level. Generally speaking, only directors will be subject to the so called corporate liability as established by statute. Officers will be subject to liability under the general principles of the civil law or labour law. Directors and officers do share other forms of liability (administrative, fiscal, criminal). Generally, officers comprises senior management that implements the decisions of the governing body of the company (the Board, the Single Director). Officers are normally appointed by the Directors.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Duties

The duties refer mainly to stock corporations (both listed and non-listed companies), but most are also applicable to private limited companies (sociedades de responsabilidad limitada). These are the two most common corporate vehicles in Spain.

(a) Duty of diligent management: directors are required to perform the job with the diligence of an orderly entrepreneur and a loyal representative. Further, each one of the directors must inform himself diligently about the running of the company;

(b) Duty of care: the directors must comply with any duties imposed by the law and the articles of association in the interest of the company;

(c) Duty of loyalty: this comprises a number of specific duties the common rationale of which is that the director or certain related persons as defined may not take personal advantage of the company. This includes, among others, the prohibition of insider dealing, the duty to disclose conflicts of interest with the company in the annual corporate governance report, the duty to disclose in the annual report any participation in companies with the same, similar or complementary corporate object, any positions they may have in those companies and the carrying out of any trading activities which are the same, similar or complementary to those of the company; and

(d) Duty of confidentiality: directors must keep secret all information that may have a confidential nature even after they should have ceased as directors, with certain exceptions.

The corporate rules also provide for a number of specific duties which are scattered throughout the applicable corporate laws, including additional specific duties for directors of listed stock corporations.

Liability

The general liability rule is that the Directors shall be liable to the company, the shareholders and the company's creditors for any damage they may cause for any actions or omissions that are contrary to the law or the Articles of Association or for those actions carried out in breach of the duties outlined above.

Should the company have a Board of Directors, all the members of the Board that carried out or passed an unlawful action or resolution shall be *jointly and severally liable*, except those that prove that did not participate in the approval and implementation of the damaging action or resolution and further ignored its existence, or that being aware of it, did all that was in their power to prevent the damage or at least opposed it explicitly;

The business judgment rule which can operate as a harbour for directors is not explicitly acknowledged in the law but can be inferred from the catalogue of duties mentioned above.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In Spain there is no such explicit provision but it is implied that the corporate interest comprises the interest of the shareholders as a whole. However, Directors can be liable to the individual shareholders for those of their actions that in the scope and course of the business may damage their

interests directly (Article 135, Joint-Stock Corporations Act 1989). Directors, as any other person, also have the general legal duty of not harming anyone, so they can also be liable in tort to the individual shareholders under the general civil rules.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As in the case of individual shareholders, Directors can be liable to third parties for those of their actions that in the scope and course of the business may damage their interests directly (Article 135, Joint-Stock Corporations Act). Directors, as any other person, also have the general legal duty of not harming anyone, so they can also be liable in tort to third parties under the general civil rules.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Administrative

The general rule is that liability for any administrative (regulatory) infractions is always personal in the sense that no one should answer for any infractions committed by others, but if several persons are legally required to jointly comply with any legal obligations, then such persons shall answer jointly and severally for the infractions committed and the penalties that could be imposed. Also, those persons required by the law to prevent the administrative infractions committed by others may be liable on a joint and several, or subsidiary, basis, where such liability is specifically imposed by the laws that regulate the various disciplinary regimes. The administrative liability is compatible with the wrongdoer's duty to reinstate any situation affected by the infraction and with the payment of damages. One then should look for the specific regulation that may be applicable for each sector of business activity in order to establish the catalogue of infractions and the possible penalties. E.g., banking, insurance, financial entities, labour, etc.

Tax

Except as otherwise explicitly provided for in the specifically applicable tax law, liability may only be imposed on a subsidiary basis. This means that the Tax Authorities must first seek collection of taxes from the Company. However, the Tax Authorities can provisionally seize assets of the directors as security to ensure collection of taxes while the required investigation process is taking place.

Liability may also be imposed on a joint and several basis with the Company in certain events, among others: if the director willingly causes the tax infraction, or actively cooperates in its commission; if the director willingly causes or actively collaborates in the transfer or hiding of the Company's assets to hamper or prevent the collection of taxes; and if the director negligently breaches an attachment order and the like. Most of these cases in fact involve fraud on the part of the director. For this reason liability is extended to penalties, surcharges and interest.

Criminal

The law makes directors personally liable although they might not meet the conditions, qualities or relations required by the relevant type of crime or fault in order to be an active subject of said crime, if said circumstances are met by the Company itself. If the penalty is a fine, the Company will be jointly and severally liable for it. Criminal offences may be a significant source of civil liability.

In the context of any company, there are a number of potential crimes for which directors may end up being held liable. Notably, crimes against the rights of the employees; the so called corporate crimes (forgery of annual accounts, fraudulent disposition of Company's assets, adoption of resolutions with fictitious majorities, etc.); crimes involving tax evasion; fraudulent insolvencies, and crimes against the environment.

In addition to criminal convictions, under certain circumstances a judge may order the company's closure, its dissolution, or the prohibition to continue the activities connected to the crime, etc.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Please see 4 above. As third parties the position would be similar. Please recall that there are specific criminal offences against the rights of the employees for which a director could be held liable.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under Law 22/2003, of 9 July, on Insolvency, effective since 1st September 2004, as amended, the insolvency must be classified by the court as fortuitous or guilty. It shall be classified as guilty when it was originated or aggravated by wilful misconduct or gross negligence of the directors (Section 164.1). It will be presumed that the

directors acted in bad faith or with gross negligence if they failed to apply for the declaration of insolvency in the cases set forth by the law, or did not cooperate with the court and the insolvency administrator. This presumption admits proof to the contrary. The court will pass judgment in due course classifying the insolvency either as fortuitous or guilty and attaching a number of harsh consequences against the relevant directors in the latter case. Among others, the role of the insolvency administrator is to present a report to the court evaluating the insolvency either as fortuitous or guilty, along with a proposal of resolution for the court to decide.

8. What remedies are available?

In the context of insolvency, the judgment can order the forfeiture of any rights directors could have as creditors, the return of all assets they would have obtained unlawfully from the insolvent company and the payment of damages. In the event that the liquidation of the insolvent company were opened, the judgment could also order the current directors and those that occupied that position within the two years immediately preceding the declaration of insolvency, to pay the creditors that part of their credits which would not be covered by the insolvent company's assets. Directors' assets can also be seized by the court in the course of the insolvency proceedings.

9. Who has the right to claim?

There are two main types of claims in the corporate context:

(i) Corporate liability action: it may be brought by the company itself; failing it, derivatively, by the shareholders (representing at least 5% of the share capital) and failing the shareholders, derivatively, by the creditors provided the company's assets are insufficient to cover their credits, subject to the fulfilment of certain other requirements;

(ii) Individual liability action: any shareholders and third parties have also the right to sue the directors in pursuit of indemnification for the actions of the directors that may damage their interests directly.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

It is generally accepted that D&O insurance is permissible under Spanish law.

The Company or the director in his/her own name may purchase cover. In practice it is the Company.

11. Are there any corporate procedural prerequisites to effecting cover?

There are no explicit rules in Spain but certain safeguards should be taken by inference of corporate rules in view of the peculiar nature of D&O insurance, and of certain trend in case law. In Spain D&O insurance is normally purchased by the Company on its own behalf and on behalf of the directors. Questions related to the nature (if it is a form of salary for directors), financing and deductibility taxwise of premiums arise. The potential conflict of interest between the Company and the directors is more than theoretical. For this reason directors should refrain from participating in the decision making process (on whether to purchase cover or not) pursuant to Article 127 ter of the Joint-Stock Corporations Act and refer the matter to the shareholders assembled in meeting.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Prior to the conclusion of the contract, the policyholder (i.e., the buyer of cover, normally the Company) is subject to the duty to disclose to the Insurer, pursuant to the questionnaire submitted by the Insurer, all the circumstances known by the policyholder that may be relevant for the evaluation of the risk. The policyholder will be relieved from said duty if the Insurer does not submit a questionnaire or, submitting it, there are circumstances that may be relevant for the evaluation of the risk but are not covered in the questionnaire.

13. Are there any tax implications connected to the purchase of D&O cover?

Premiums paid by employers for civil liability policies issued to their "workers" are not considered a benefit in kind for them (section 42.2 (e) of the Personal Income Tax Law 35/2006 of 28 November).

Officers can qualify as workers even though their relation with the Company is characterized by statute as a special labour relationship. Therefore, a D&O policy would not be a benefit in kind for Officers.

The position differs as far as Directors are concerned. In principle their relation with the Company has a civil/commercial nature, they are not "workers" or employees, not even subject to a special labour relation. So, if a Director does not perform any executive functions in the Company, a D&O policy would be considered a benefit in kind for that Director and hence the premium would be subject to personal taxation. The question is not so clear where the Director also carries out an executive function in the Company, but it is likely that the Tax Department would also take the view that it is a benefit in kind and therefore subject to personal taxation.

In any case, the Company may deduct taxwise the premium paid.

Local Taxation of policies

There is an Insurance Premium Tax (IPT) which currently amounts to 6% of all premiums collected in Spain in non-exempt lines. A D&O insurance policy is not exempt. The IPT is ultimately paid by the insured but the Insurer is required to collect and deliver it to the Treasury. For this

purpose, the Insurer must file returns on a periodical basis (monthly and one annual summary).

Insurers are also required to pay to the Insurance Compensation Consortium (CCS), a government-owned entity, a levy or surcharge of 3 per mille (there is a project to reduce it) on all premiums for the insurance of risks located in Spain other than premiums for life and export credit insurance, which is intended for the financing of the winding up of insurance companies.

Lastly, Insurers are required to collect from insureds and turn over to the CCS a tariff (in fact a premium) for the coverage of so called extraordinary risks. This tariff is paid on certain lines only. Liability is not one of them.

The levies and tariffs payable to the CCS are ultimately payable by the insured but the Insurer is directly liable vis-à-vis the CCS. The EEA Insurer insuring Spanish risks from its own home country under the freedom to provide services regime must appoint a fiscal representative in Spain.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

Not in Spain.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

It is common to purchase it in Spain, but reinsurance protection is commonly sought overseas.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The position is similar in Spain to the example given in the template. Whilst third parties are not named beneficiaries, they have a direct action against the insurer.

17. What is commonly covered?

The position is similar in Spain to the example given in the template.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

As a general rule, section 19 of the Insurance Contract Act 1980 excludes from cover losses caused by the insured acting in bad faith. This is the first standard exclusion in all insurance policies which however may not be raised against the injured third party. Also, criminal, civil and administrative fines may not be insured based on the principle of individuality of penalties and public policy, and this has been confirmed recently by an opinion of the Spanish Insurance Supervisor (which however is not binding). Arguably, fines for offences arising out of non-deliberate acts or omissions, could constitute an exception to this general principle but this has not been settled as a matter of law.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

The insureds and third parties who may consider themselves affected by the conduct of the directors. Third parties have a direct action against the insurer (Section 76, Insurance Contract Act 1980).

20. What is the procedure for bringing a claim?

The standard term is 7 days or more (if agreed) to report the claim (if the risk is a mass/consumer risk). Where so called large risks are concerned party autonomy prevails so the parties may agree otherwise (shorter or longer terms or indeterminate expressions such as “as soon as possible” and the like).

Failure to report timely will not entitle the insurer to deny the claim, but only to ask for damages for the delay, if any, save that the insured acted in bad faith or with gross negligence. In large risks parties could agree otherwise.

With regard to time limitations, any action from the insured against the Insurer is time-barred after two years. The third party is subject to the applicable statute of limitations: if it is a claim in tort, one year; if in contract, 15 years.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Generally, indemnification is legally viable if an individual’s liability arises out of fault or negligence, but not fraud, malice or willful misconduct. Liability arising out of fraud or gross negligence may not be waived (Section 1102, Civil Code, and relevant case law).

A contract where a Company agrees to indemnify or hold harmless a director from any and all liabilities and responsibilities stemming from fault or negligence in principle would be valid in respect of personal claims brought by individual shareholders and other third parties in their own right.

The question is less clear in respect of claims brought by the Company itself or derivatively by the shareholders or creditors. Bearing in mind that Directors will not be exempt from liability by the approval, ratification or adoption of the damaging act or resolution by the general meeting of shareholders, an indemnification agreement for a corporate liability action signed ex ante facto would equate to an anticipated discharge of liability and would likely be null and void and thus unenforceable, even if approved by the general meeting of shareholders.

However, the shareholders assembled in meeting may decide not to bring the corporate liability action, or may settle or waive it (except in case of fraud or gross negligence), thus holding the director effectively harmless in whole or in part. Note that shareholders representing at least 5% of the share capital have the right to oppose the proposed settlement or waiver, and also to bring the corporate liability action in the name of the Company in certain events.

22. How is the indemnification dealt with in practice?

The approach is the same in Spain as in the template: to the fullest extent permissible in law, the scope of which is doubtful.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

So called codes (Olivencia) and reports (Aldama) and more lately a unified code on corporate governance (Conthe) have been issued in Spain. Part of those recommendations has been codified, hence becoming compulsory. Part are still voluntary. Although they would not have an "automatic" shield if they show that they complied with the codes, that high level of compliance would effectively shield them in all likelihood in the sense that it would be very difficult for a claimant to sustain his claim.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

Under certain circumstances directors are required to convene the shareholders meeting in two months time in order for it to resolve about the dissolution of the Company, or to apply for the declaration of insolvency or request from the relevant court that the Company be dissolved, among others, where losses reduce the assets of the company to less than half of the share capital. Directors who fail to do that shall be jointly and severally liable for the Company's debts incurred after the cause for dissolution arose. Although with qualifications this liability is deemed to be strict.

A new law, effective from 13 December 2008, establishes that losses caused by the deterioration of certain accounts will not be considered in order to calculate the loss of capital and therefore the duty to convene the shareholders. These accounts are fixed assets, real estate investments and stocks (inventories). This rule will be in force for the next two business years. So, even if the company were in the state of dissolution the directors are not required to take action along the lines explained above for two business years (2008 and 2009). This will alleviate directors' liability.

This should not exempt directors though from applying for insolvency proceedings if any of the grounds envisaged in the Insolvency Act in which that application is compulsory would arise.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

None that I am aware of. In any event criminal fines are uninsurable.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

Insolvency proceedings in certain business areas, namely real estate promoters, have triggered claims substantially. It is expected that this trend will continue.

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Spain 3

GUILLERMO SAN PEDRO MARTINEZ, URÍA MENÉNDEZ

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

In accordance with the current Spanish Public Limited Liability Companies Act (hereinafter, "LSA")[1], both ordinary directors and *de facto* directors (*administradores de hecho*) can be held liable under the legal regime of responsibility that it sets forth. This regime makes no distinction between executive and non-executive directors.

Unlike other jurisdictions, neither the LSA, nor any other Spanish law sets forth any express provision regarding shadow directors. The aforementioned notwithstanding, most scholars argue that shadow directors can be held liable as well, since they can be deemed as *de facto* directors, concept which includes all who manage a company without having been formally appointed as its directors. However, please note that courts in Spain normally require strong evidence to hold *de facto* directors liable.

In addition, it is worth mentioning that directors of a parent company vested with representative and decision-making powers in respect of its subsidiaries could be regarded as de facto directors of such subsidiaries.

Regarding officers, while other jurisdictions have taken the approach of equalising directors and officers for liability purposes, Spanish corporate law has not set forth any special regime for officers' liability. Officers are employees of the company and in case of wilful or negligent conduct of such officers, the company shall be held liable vis-à-vis third parties (since under Spanish law, an employer is deemed liable for the actions of its employees in the performance of their roles as employees). However, in this case, the company would be entitled to claim damages against the officers if it proves the wilful or negligent conduct of the officer.

2. What are the duties/liabilities of directors and officers to the company, its shareholders and third parties?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors are liable vis-à-vis the company, its shareholders and its creditors for the damages caused by acts or omissions breaching (i) the law (either the LSA or any other applicable legal provisions), (ii) the company's by-laws, and/or (iii) their inherent duties as directors.

Moreover, the LSA also sets forth a liability regime for directors in mandatory dissolution events. These are situations where directors are legally obliged to request the dissolution of the company, the most relevant example being the capital impairment situation of the company[2]. In these cases, directors will be held liable for the company's obligations - including its debts - if they do not comply with the regime of mandatory dissolution.

Regarding the inherent duties of directors, the LSA sets forth a series of duties that must always be complied with by all directors in all the acts or transactions carried out while holding office:

(i) duty of loyalty: it comprises, *inter alia*, not taking advantage of the name or business opportunities of the company they represent, and communicating any conflict of interest to the company;

(ii) duty of secrecy: directors must not disclose any confidential information of the company, not even after leaving the company, unless it is otherwise legally required (e.g. when the disclosure has been requested by a court of justice);

(iii) duty of care: directors must exercise the care of a prudent and diligent businessman and loyal representative, carrying out all responsibilities inherent to their position and remaining informed of the progress of the company's business;

(iv) fiduciary duty: directors must comply with all applicable legal and statutory provisions, and always abide by and pursue the company's interests.

This liability may be claimed by the company by means of the corporate action or individually by the shareholders and third parties directly affected (e.g. creditors) by means of an individual action.

3. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In Spain, a legal entity can not be found guilty by itself of criminal offences, following the general principle of *societas delinquere non potest*[3]. Thus, the Spanish Criminal Code (*Código Penal*) attributes criminal liability to the individuals who actually carry out the criminal conduct (either by act or by omission) in the name and on behalf of a legal entity (e.g. a director, a legal representative, an officer, or any other individual with managing duties).

The Spanish Criminal Code sets forth that: "*the individual who acts as legal or de facto director of a legal entity, or in the name thereof or holds the legal or voluntary representation of another individual, will be personally liable, despite the fact that he/she does not meet the conditions, characteristics or relationship requisites set out in the corresponding description of the crime or misdemeanour to be its author, if the said circumstances are met by the entity or person in whose name or representation he/she acts*".

This does not create an automatic presumption that the director is liable. Criminal liability for a director arises solely if he/she had knowledge and intent of committing the punishable offence (or if he/she demonstrated gross negligence in the event of certain crimes which do not require an express intent to be committed).

The Spanish Criminal Code also sets forth certain so called "corporate criminal offences", which are offences related to the violation of corporate obligations or the abusive use of powers. By way of example, the inclusion of false statements in the annual accounts or in other documents aimed at evidencing the legal or economic situation of the company, in a way that it may cause economic damage to it, its shareholders, or third parties, is considered a criminal offence and liability is generally attributed to the directors who signed the relevant documents.

Spanish law also contemplates regulatory liability (i.e. fines) for directors in the event of breach of the provisions regulating the transactions of own shares and financial assistance. Likewise, if the company operates in any Spanish regulated market (*inter alia*, banking, insurance, energy, telecommunications, etc.) both the company and its directors would have to comply with the relevant provisions of each market or face administrative sanctions.

4. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As a general rule, administrative liability arising from breaches of employment regulations shall be borne by the employer (i.e. the company). Notwithstanding this, in their capacity as company creditors, employees are theoretically entitled to exercise either the corporate action for liability against directors if the company and shareholders fail to do so and provided the company's assets prove insufficient to meet wage-related debts, or the individual action for a behaviour detrimental to their interests.

Furthermore, directors and officers may be held liable of certain criminal offences committed against the employees rights, such as not complying with health and safety regulations or causing reckless homicide or reckless body harm.

5. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

According to the Spanish Insolvency Proceedings Law (*Ley Concursal*), a court can order the seizure of the assets of directors and liquidators (liquidadores) if the insolvency may be classified as fraudulent (*concurso culpable*) and the assets of the company prove to be insufficient to satisfy all the company's debtors.

Also, if the insolvency of the company is deemed to have been fraudulent and the proceedings enter into the dissolution phase, the court ruling may impose on the company's directors and liquidators (which includes those who served as directors during the two years prior to the declaration of the company's insolvency) the obligation to pay, totally or partially, the debts of the company which could not be satisfied once all the company's assets had been liquidated.

6. What remedies are available?

Under criminal and regulatory liability, the remedies are basically limited to fines (although in criminal offences, directors may be held also liable for damages). Concerning the general regime - liability towards the company, its shareholders and directly affected third parties - the remedies available in the LSA and in other ancillary provisions include the obligation to indemnify for the damages caused and could also include any lost profits not realized due to the director's actions (or lack thereof), if duly proved (courts in Spain usually require strong evidence to award lost profits to claimants).

7. Who has the right to claim?

As it has already been stated (please refer to the answer to question 1.2 above), the general regime contained in the LSA, confers the right to claim for damages to the company itself, to its shareholders, and to third parties directly affected (such as creditors).

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

8. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of insurance to cover the liabilities of directors and officers (D&O) is legal and its subscription has been commonly spread among Spanish companies in the last years. Nevertheless, it is worth mentioning that D&O insurance is not subject to an express regulation under the current Spanish Insurance Law (*Ley del Contrato de Seguro*).

While D&O cover may be purchased either by the directors and officers or by the company itself, the current trend in Spain is that D&O cover is purchased by the companies.

9. Are there any corporate procedural prerequisites to effecting cover?

Spanish law neither foresees any specific corporate procedure, nor expressly requires the passing of specific resolutions for the purchase of D&O cover. Therefore, general corporate law principles need to be applied in order to ascertain who is entitled to decide upon the subscription of this insurance coverage.

Most scholars consider that, unless the by-laws expressly foresee a regime for the purchase of D&O insurance - which is not likely-, the subscription of this insurance should be approved by a resolution of the General Shareholders Meeting of the company, rather than through a decision of the management body of the company. The reason for such a procedure is that directors might find themselves facing a conflict of interest when purchasing D&O cover in the name and on behalf of the company (i.e. by means of a board of directors' resolution or through delegation).

Thus, even though the purchase of D&O cover solely by means of a decision of the managing body of the company is, in principle, possible, the most appropriate procedure would be the passing of a resolution agreeing the purchase of the insurance by the General Shareholders Meeting, thereby avoiding any possible conflict of interest.

10. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Spanish Insurance Law expressly requires that the potential insured party discloses any known information which could affect the risk assessment of the insurer, all according to the questionnaire that the insurance company is entitled to present to the potential insured party prior to entering into the insurance agreement. Any false statement in the questionnaire entitles the insurance company to terminate the contract and retain the already paid insurance premium(s).

In practice, questionnaires tend to be very thorough, especially for listed companies. Additionally, it is common that the insurer requests to review certain documents such as the annual accounts of the two fiscal years prior to the purchase of cover, and the latest financial data available for the ongoing fiscal year.

Also, once D&O cover has been purchased, and while it is still in effect, either the insured party or the policy-holder - should they not be the same - must notify the insurance company of any circumstances which may increase the risk assessment of the policy.

11. Are there any tax implications connected to the purchase of D&O cover?

If a company undertakes the obligation to pay premiums of D&O insurance for the benefit of its directors, from a tax perspective, such directors will be obtaining an employment income in the amount of the premiums paid by the company to the extent that this benefit arises from its role as directors of the company. In addition, the expenses recorded by the company as a result of the obligation to pay D&O insurance premiums will be tax deductible for Corporate Income Tax purposes.

12. Is insurance of D&O exposures compulsory in respect of any type of company?

Insurance of D&O exposures is not compulsory for Spanish companies. However, certain regulated activities require that the company subscribes a liability coverage (although it does not normally include its directors liability).

13. Is D&O insurance usually purchased locally or purchased from overseas markets?

While D&O insurance is usually purchased in Spain, most policies found in the Spanish market are heavily influenced by Anglo-Saxon legal concepts, which may sometimes contravene the general principles of Spanish Insurance Law (some of them imperative and directly enforceable even if the parties state otherwise in their insurance agreements).

Without prejudice to the aforementioned, this trend is slowly changing thanks to the spread of this kind of insurance in Spain - particularly among listed companies -. Still, to this date, a good number of the policies found in the market in Spain are still mere adjusted translations of their Anglo-Saxon counterparts.

THE EXTENT OF COVER

14. Who are the beneficiaries of the insurance?

Most D&O policies in Spain include both the company and its directors and officers as beneficiaries for the claims made against them.

15. What is commonly covered?

The cover under the D&O policies in Spain is usually quite comprehensive, covering liability from damages caused by breaches of the law, the company's by-laws and the general duties of directors, as well as covering the legal costs incurred in the defence of the received claims. Administrative sanctions and fines may sometimes be included under the policy. Yet, that is not always the case, since some policies expressly exclude them.

Usually, the cover extends not only to claims against directors and officers, but to claims against their heirs and spouses as well. Likewise, the cover usually extends, under certain limitations, to the claims against the directors and officers of the subsidiaries of the parent company which purchases D&O cover.

16. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Common exclusions include criminal liability, tax liability, personal and property damages (e.g. by defective products), breaches caused by wrongful misconduct (*dolo*), claims filed in the United States and/or Canada and claims subject to the laws of the United States and/or Canada. As mentioned under section 2.8 above, fines and administrative sanctions are sometimes expressly excluded.

BRINGING A CLAIM UNDER THE INSURANCE

17. Who can bring a claim under the D&O cover?

Pursuant to certain imperative provisions of the Spanish Insurance Law —applicable even if the insurance is deemed to be a "high-risk insurance" (*seguro de grandes riesgos*) where other normally imperative provisions of said law would not apply— both the insured party and the person who has suffered the damages caused by the director or officer have the right to bring a claim under the D&O cover.

This is an imperative right conferred by law, and therefore it would be enforceable even if the insurance policy does not expressly contemplate such possibility (which is the case of most policies marketed in Spain).

18. What is the procedure for bringing a claim?

The Spanish Insurance Law states that if the parties did not state otherwise in the relevant policy, the procedure for bringing a claim would follow the "occurrence basis system", and thus, all events which took place while the policy was in force would be covered, regardless of the time when the claim was actually made (provided that the statute of limitation had not run out).

Yet, in practice, D&O policies in Spain make use of the "claims made" system, granting an unlimited retroactive coverage (the Spanish Insurance Law requires a minimum retroactive coverage period of one year) for acts or omissions carried out prior to the purchase of insurance.

Regarding the term to communicate the claim to the insurer once the insured party, the policy-holder or the beneficiary become aware of it, the Spanish Insurance Law establishes a common seven-day period for all insurance types (including D&O cover).

This seven-day period may be extended in the policy but not reduced. In practice, D&O policies either make no reference to this period (hence, the general timeframe would apply) or expressly set forth a seven-day period. In case of failure to comply with this deadline, the insurer would be entitled to claim for the damages caused by this delay.

INDEMNIFICATION

19. Can the company indemnify its directors and officers? If so, for what?

The legal institution of indemnification is not as widespread in Spain as it is in other jurisdictions (such as the UK). Some scholars argue whether or not it could be possible under Spanish laws to indemnify directors and officers for claims arising from third parties by including the adequate provision in that sense in the by-laws of the company.

From a purely practical standpoint, while some scholars had been raising their support to the admission, with certain limitations, of indemnification clauses in companies' by-laws, it would be more advisable to resort to the purchase of D&O cover rather than to rely solely on the uncertain enforceability of these clauses.

20. How is the indemnification dealt with in practice?

As mentioned in our answer to question 2.12 above, in practice, Spanish companies do not make use of indemnification. Instead, they resort to the purchase of D&O cover for their directors and officers.

ANY OTHER BUSINESS

21. To what extent is corporate governance utilised to shield directors and officers?

Corporate Governance (*Gobierno Corporativo*) regulations, have been recently enacted in Spain. The Unified Good Governance Code (*Código Unificado de Buen Gobierno*), whose principles and recommendations are currently applicable to Spanish companies, was made public by the Spanish Securities Markets Commission (CNMV) in 2006.

In principle, corporate governance regulations are aimed at listed companies, although there is nothing to prevent any other company from voluntarily considering and adapting to its business the principles and rules set out in the Unified Good Governance Code.

While non-compliance does not give rise to a responsibility claim, the Unified Good Governance Code goes beyond mere moral suasion techniques. According to the "comply or explain" (*cumplir o explicar*) principle adopted under the Spanish corporate governance legal system, companies may freely establish whether or not to follow the corporate governance recommendations, bearing in mind that any failure to comply with corporate governance precepts requires an explanation to the market, and could therefore indirectly cause some harm to the company (e.g. potential reduction in the stock price).

22. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

There are no anticipated changes to the extent of directors and officers liabilities.

23. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

A proposal for the modification to the current Spanish Insurance Law is being drafted by the Ministry of Justice. Currently, only a draft of the basic principles of the new law is available. Such draft of principles does not seem to include major changes in the current regulation affecting D&O insurance.

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1 Please note that the general provisions regarding directors and officers' liability contained in the LSA apply both to public limited liability companies (*sociedades anónimas*), and to private limited liability companies (*sociedades de responsabilidad limitada*).

2 Caused when the company's net worth falls below one half of the company's share capital.

3 Companies can not commit criminal offences.

Sweden

MANNHEIMER SWARTLING

Form and nature of liabilities to which corporate representatives are exposed

This memo purports to provide an analysis of the form and nature of liabilities which boards of Directors and Officers in Sweden are exposed to pursuant foremost to the Swedish Companies Act and the insurance products available to cover such liabilities. Directors and Officers mentioned in the Companies Act are the board of Directors and the managing Director. Swedish companies have only one board of Directors and the managing Director is not necessarily a member of the board. Although other Officers may have a delegated authority from the board of Directors and managing Director, they are not recognised as Directors and Officers under the Companies Act. Nevertheless, they may become liable for causing damages to, e.g., third parties.

De facto and shadow Directors, which are terms that refer to individuals who act on behalf of the company without having been formally appointed, do exist under Swedish law, but they occur only in rare occasions and there is no specific regulations regarding these Directors.

Since the civil law, and not common law, system is used in Sweden, the case law is used to interpret statutory law. However, this memo only purports to explain the Directors' and Officers' liability under Swedish legislation and regulations.

1. Who are considered to be responsible directors and officers?

If the company's articles of association does not state otherwise, the shareholders elect, at the annual shareholders' meeting, the responsible Directors who are given a legal authority to appoint the managing Director and other Officers without shareholders' prior consent. As mentioned, the board of Directors and the managing Director are the only Officers recognised under the Companies Act but other Officers may have a delegated authority and hence may become liable for damages caused to third parties or shareholders.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and Officers must adhere to the rules in the Companies Act, the board of Directors' work regulation and potential specific legislation depending on the company's business. Since they are fiduciaries of the company, they must act with a standard of care, in the best interest of the company. Whilst the standard of care varies depending on, e.g., the type of business and the structure of the company, board members are always required to be aware of the company's financial condition and make informed decisions based on sufficient data. If the Directors or Officers negligently or wilfully breach their duties, they may become liable for the damage that they have caused the company.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

If the company's articles of association do not state otherwise, the responsibility of the Directors and Officers is to endeavour to generate profits for distribution to the shareholders. If Directors or Officers act negligently or wilfully when causing losses or minimising the shareholders' profits, they may be obligated to reimburse the shareholders for their loss.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and Officers are usually not personally liable for damage caused to third parties without contractual relationship with the company. An exception to this rule is environmental legislation where Directors and Officers, in some situations, have strict liability. Another example of when the strict liability applies is when the company deals with hazardous activities.

The Companies Act provides liability provisions for Directors and Officers toward company creditors, which under Swedish law are considered to be third parties. The Directors and Officers may, inter alia, become liable for the creditors' damages where they have failed to observe the company's impaired capital. Thus, they may become jointly and severally liable for any debts of the company which occur following the impaired capital. Also, Directors and Officers may become liable for distributing unlawful dividends to shareholders in violation of the Companies Act. If so, recipients who have been aware, or should have been aware, of the violation are obligated to return the dividends with interest. If the recipients are not able to return the dividends, any person who participated in the decision regarding the dividends or the execution thereof, such as board members, becomes personally liable for the deficiencies. The Directors and Officers may also be liable for damages caused to creditors if infringing the prohibition on lending money to affiliated companies or persons connected with the company, as set out in the Companies Act ("unlawful financial assistance").

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under Swedish law, a company cannot commit a criminal offence. However, Directors and Officers may incur criminal liability for a number of offences under the Criminal Code, such as credit fraud, breach of trust and bribery, which may lead to fine or imprisonment. Further, Directors and Officers are strictly liable for violations of the Tax Payment Act and breach thereof can also lead to fines or imprisonment.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Under the Companies Act, Directors and Officers do not have specific obligations towards the employees of the company. Nevertheless, there are some duties imposed in other legislation, such as the Occupational Safety and Health Act. For example, an Officer may be fined if he/she has employed a minor, has given the regulator false information about the work environment or if he/she has disabled a safety device which may jeopardise the wellbeing of the employees.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

When in bankruptcy, the company is managed by an administrator and the Directors and Officers have an obligation to co-operate with the administrator. Furthermore, they may not act in a way that damages the company and they have no right to dispose property that belongs to the company. If these obligations are infringed, the administrator has the right to, under some circumstances, recover property that has been disposed of.

8. What remedies are available?

The remedies differ depending on which statute that has been violated. For example, if the prohibition on lending money is infringed, the recipient shall repay what he or she has received but if the statute regarding impaired capital has been violated; the persons involved may become personally liable for the company's debts that have arisen after the negligent act. Whilst the remedies under the Companies Act often entail an obligation to reimburse the company, shareholders or third parties for any financial loss that they have incurred, violations of the Criminal Code, environmental legislation or the Tax Payment Act often lead to fines and/or imprisonment.

9. Who has the right to claim?

The Companies Act provides the company, shareholders and third parties with a right to claim damages from Directors and Officers. Claims for damages on behalf of the company may be brought by the shareholders if a minority consisting of owners of not less than ten per cent of all shares in the company have supported a resolution to bring such a claim or, with respect to a member of the board of Directors or the managing Director, have voted against a resolution regarding discharge from liability.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

There are no legal obstacles for companies to purchase D&O insurance, as long as it serves the best interest of the company and the shareholders.

11. Are there any corporate procedural prerequisites to effecting cover?

The Companies Act does not mention any procedure for effecting cover of D&O insurance. Nevertheless, it is argued in legal literature that D&O insurance resembles remuneration for the board of Directors and should therefore, at least regarding Directors insurance cover, be decided by the shareholders as other queries concerning remuneration for the Directors. However, in practice generally decision on whether to purchase the insurance or not, is made by the board of Directors.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

The Swedish Insurance Contracts Act imposes an obligation to provide the insurer with important information and to give true and complete answers to the insurer's questions. The policyholder shall also present information of apparent significance for the risk assessment notwithstanding that the specific information was not requested by the insurance company.

13. Are there any tax implications connected to the purchase of D&O cover?

There are no tax implications connected to the purchase of or benefits from the insurance cover. The Swedish Tax Agency has previously questioned if premiums should be regarded as taxable benefits for the Directors and Officers, but the Administrative Supreme Court has finally ruled that the premiums paid by the company are not to be regarded as taxable benefits.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

The purchase of D&O insurance is not mandatory for any type of company.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

The need for D&O insurance differs depending on, for example, the size and business conducted by the company. Whilst smaller companies, with limited need for cover, often purchase the insurance from local insurance companies, larger companies often, at least to some extent, turn to foreign insurance companies.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

The insurance usually cover acts taken by the company and all of the members of the board of Directors (including deputy members), the managing and deputy managing Directors and other Officers. Also, the insurance usually covers actions taken by former Directors and Officers, if the wrongful acts have been committed during their time as corporate representatives.

17. What is commonly covered?

D&O policies cover actions taken by Directors and Officers in their line of business and within the scope of their work regulation, regardless of whether the basis of the claim for damages is that a wrongful act has been conducted pursuant to a contract or legislation. Indirect damages, e.g. environmental damages, are also covered, provided that the actions have not been carried out wilfully.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Conducts from Directors or Officers that violate a contract or law, and that have been carried out deliberately or grossly negligent, as well as criminal offenses, are usually excluded from the insurance coverage.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Besides the insureds, the company as policyholder may bring a claim under the D&O insurance for so called "company reimbursements".

20. What is the procedure for bringing a claim?

The procedure begins with the policyholder reporting a damage claim to the insurer which undertakes to investigate if the Directors or Officers are personally liable for damage and negotiate with the claimant. The insurer assists at proceedings and hearings but the Director or Officer may consult his own lawyer, even though the insurer usually has to approve this. Finally the insurer pays the personal liability fee and legal costs, if any, that the policyholder or the insureds has been obliged to pay.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

The Companies Act does not mention indemnification of Directors and Officers. However, because the general liability provision under the act is compulsory, Directors and Officers cannot be indemnified for damage suffered by the company or the shareholders in advance. It is only after such a liability has arisen that the company, with the consent of more than 90 per cent of the shareholders, may agree to indemnify the liable Director or Officer.

22. How is the indemnification dealt with in practice?

For damage in accordance with item 3.12 above, the shareholders could also enter into a shareholders' agreement not to bring an action against the Directors, but such an agreement is not binding under the Companies Act (but instead under the general law of contract). To be binding under the Companies Act, more than 90 per cent of the shareholders have to vote for indemnification after a liability for the Director has incurred.

It is possible for the company to indemnify the Directors and Officers for damage claims brought by other parties than the shareholders or the company by entering an indemnity agreement ("third party claim"). The company's cost for the reimbursement of the Directors and Officers is generally covered by the D&O insurance.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

Corporate governance is primarily utilized to protect the shareholders, and possibly other stakeholders. As mentioned above Directors and Officers must not, neither negligently nor wilfully damage the company or shareholders. By acting compliantly with good corporate governance practice, the risk of negligently or wilfully causing damages is reduced.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

There are no anticipated changes to the extent of Directors' and Officers'' liabilities.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

There are no anticipated changes to the legality of D&O insurance cover or indemnification.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

There are no particular areas to watch out for, besides those mentioned above concerning strict liability for the company representatives (e.g. hazardous activity).

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Switzerland 1

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A Comparative Analysis of the Form and Nature of Liabilities to which Corporate Representatives are Exposed and the Insurance and Indemnification Products Available to Cover such Liabilities

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible Directors and Officers?

According to article 754 of the Swiss Code of Obligations (CO) the members of the board of directors (directors) and all persons engaged in the management (officers) or liquidation are liable to the company, as well as to each shareholder and to the company's obliges for the damage caused by an intentional or negligent violation of their duties.

In practice, the liability of article 754 CO for administration, management and liquidation includes the board of directors, the top management of the company (officers), the liquidators and trustees, but possibly also so-called substantive bodies like "*grey eminences*", hidden (shadow) directors, majority shareholders, the holding company and entities that take part in decision-making of the management by an agent who is bound by instructions. Besides the liability exceptionally also comprehends more subordinated functions like general managers, commercial agents and advisers, where a substantial-functional concept of the board exe-cutes.

In addition to the persons mentioned above, also so called *virtual bodies* may be liable according to article 754 CO. Persons who have decisive influence on the company are considered to be virtual bodies. These virtual bodies have their control resulting from a body-specific function (for example by participation to a voting). Furthermore, if a person gives the impression towards third parties, that he/she has the competences to represent the company to the same extend as a director or an officer, a liability can also be established by this behaviour.

The position as a director, officer or liquidator (including so called virtual bodies) and the accordant responsibility last as long as the person can influence the decisions of the company. If a person, who is enrolled in the commercial register, fails to check or to arrange for the deletion in the commercial register, a liability against trustful third parties by lawful appearance can be the consequence.

The duties and liabilities of the Directors and Officers

a. Civil law

bb. The main clause of article 754 CO

It has been exposed above that members of the board of directors and all persons engaged in the management or liquidation may face liability when acting on behalf of a company. But, whoever rightfully delegates the fulfilment of a duty to an-other corporate body is only liable for any damage caused by it, unless he proves that he applied the necessary care in selection, instruction and supervision under the circumstances (article 754 para. 2 CO).

Article 754 CO is the main liability clause in stock corporation law for the directors and officers for their own behaviour.

Liability according to article 754 CO demands the conditions of damage, causality, illegality and default.

Regarding causality, there has to be causality not only between the behaviour and the violation of the legally protected right (so called liability-establishing casualty), but also between the violation of the legally protected right and the damage (so called liability-completing causality). For both the same rules and considerations apply.

There has to be a natural as well as an adequate *causality accumulatively*.

First, there has to be a natural, logical and material causality between the dam-age-endowing action and the result (*conditio sine qua non*). The action is a condition of the result and cannot be waived without the result to drop.

With regard to the liability of directors and officers, the question of causality by nonfeasance arises very often. Theoretically, nonfeasance cannot produce an external result and therefore it cannot be causal for itself. The legal doctrine over-comes this dilemma with the artifice of the hypothetical causality. First of all, it has to be checked if there is a legal duty to prevent damage by an action. If this has to be approved, it has to be checked then, if the damage would have been prevented if the legally demanded action would have been undertaken.

Concerning the standard of evidence there has to be a predominant probability for this hypothetical causality under normal circumstances and after the experience of life (for the sake of clarity, a probability of 75% is considered to fulfil the criterion of the hypothetical causality). Directors and officers can try to plead the break of causality by default of a third party, but the chances for this are in practice very low. Only the plea of a missing causality can convince the tribunals.

Because of the parallelism of the criteria of the hypothetical causality and the adequate causality, a separate consideration of the adequate causality is unnecessary in cases of nonfeasance according to the federal court.

Regarding illegality, the duty to take care according to article 754 CO is not an in-dependent condition to liability, but builds the judicial benchmark for the fulfilment of the lawful and statutory duties placed on the directors and officers.

The illegality in the field of liability according to stock corporation law – which is a strict liability in tort sui generis – consists in a behaviour contrary to duty that can result from the breach of the duty of care, the fiduciary duty or the duty of equal treatment (for this see the following section bb-ee).

For the fulfilment of the requirement of the default, slight negligence is sufficient, whereas an objectified rule of default is implemented. This means that the diligence of an experienced and diligent person of the same audience is applied for the board of directors.

In addition to the liability according article 754 CO, there is also the non-contractual liability according to article 41 CO.

bb. The fiduciary duty according to article 717 CO

The members of the board of directors as well as third parties engaged with the management shall carry out their duties with due care and must duly safeguard the interests of the Company (article 717 para. 1 CO). Circumstances being equal, they shall give equal treatment to shareholders (article 717 para. 2 CO).

The fiduciary duty according to article 717 CO has a triple nature. First of all, it contains a general fiduciary duty and duty of care that serves as a judicial guide-line for concretion of the other lawful duties and obliges the directors and officers to defend the interests of the particular company to their own or third parties' interests. From this general fiduciary duty and duty of care results a duty to accurate management and control of the assets of the company as well as a duty to supervise the management and to interfere authoritative if necessary. Secondly, the fiduciary duty according to article 717 para. 1 CO is an independent norm to prevent from intentional damage of assets. And thirdly, article 717 para. 2 CO, as an independent norm, obliges the directors and officers to equal treatment of the shareholders.

cc. The business judgment rule

Not explicitly regulated but regarding illegality under Swiss law to be allocated to the fiduciary duty according to article 717 para. 1 CO is the approach of the "*business judgment rule*" of American law. This rule provides a catalogue of criteria to answer the question if the directors and officers have made its decision in compliance with their duties.

Under Swiss law there is no such catalogue of criteria of the "*business judgment rule*", although a substantial consensus is about to become apparent. According to this consensus, the decision on business has to be made by unprejudiced directors and officers, who have been informed carefully and evaluated alternatives, the meeting has to be announced correctly, the essential points have to be in the agenda and there has to be sufficient time for discussion. If, in practice, the dam-age, the causality and the breach of the due diligence can be proved, the default is assumed while an exculpation is almost impossible because of the objectified criteria of default.

dd. The liability out of non-transferable duties according to article 716a CO

The board of directors has the following non-transferable and inalienable duties: 1. the ultimate management of the company and the giving of the necessary directives; 2. the establishment of the organization; 3. the structuring of the accounting system and of the financial controls as well as the financial planning, insofar as this is necessary to manage the company; 4. the appointment and removal of the persons entrusted with the management and the representation; 5. the ultimate supervision of the persons entrusted with the management, in particular, in view of compliance with the law, the articles of incorporation, regulations, and directives; 6. the preparation of the business report as well as the preparation of the general meeting of shareholders, and the implementing of its resolutions; 7. the notification of the judge in the case of over indebtedness (article 716a para. 1 CO).

Non-transferable and inalienable duties cannot be delegated by the board of directors to other persons. Such delegation would not prevent them from any liability. The list of the non-transferable and inalienable duties is in principle exclusive, but there are other lawful duties that the stock corporation law and other particular laws assign to the directors or officers, e.g. articles 634a, 651 para. 4, 652g para. 1, 653g para. 1, 706 para. 1, and 725 CO etc.

The board of directors may assign the preparation and the implementation of its resolutions or the supervision of business transactions to committees or individual members. It shall provide for adequate reporting to its members (article 716a para. 2 CO). To call third parties in for auxiliary functions is admissible, but does not relieve the directors and officers from liability.

ee. The liability out of insufficient organization according to article 716b CO

The articles of incorporation may authorize the board of directors to fully or partially delegate the management to individual members or third parties in accordance with an organizational regulation (article 716b para. 1 CO). This regulation organizes the management, determines the positions required and therefore, de-fines their duties, and regulates, in particular, the reporting. Upon request, the board of directors informs those shareholders and the company's obligees, who make a credible showing of an interest worthy of being protected in writing, about the organization of the management (article 716b para. 2 CO). To the extent the management has not been delegated, it shall be vested jointly in the members of the board of directors (article 716b para. 3 CO).

For tasks the board of directors has delegated permissibly in accordance with these requirements it is liable only for a breach of duty in election (*cura in eli-gendo*), instruction (*cura in instruendo*) and custody (*cura in custodiendo*)

b. Public law

aa. The liability for old age and survivors insurance contributions (article 52 AHVG)

There is a long and forensically tested practice of the social insurance institutions to collect outstanding old age and survivors insurance contributions in bankruptcy cases by the subsidiary liability of directors and officers. The legal basis therefore is article 52 AHVG (law of old age and survivors insurance). The term of the entrepreneur according to article 52 AHVG contains the formal and virtual bodies (directors and officers) of entities. The federal court interprets article 52 AHVG in such a way that it equals a liability based on causality with the possibility of exculpation.

bb. The liability of the bodies of the pension fund (article. 52 BVG)

According to article 52 BVG (law of professional pension fund) persons who are assigned with the administration, management or control of the pension funds are liable for the loss they inflict to the pension fund.

Only the institution, respectively its estate, has the right to claim according to article 52 BVG, but not the insured persons.

bb. The liability of the bodies for the payment of VAT and withholding tax

Article 32 of the Federal Statute of Value-Added Tax and article 15 of the Federal Statute on Withholding Tax contain a joint liability of the directors and officers, together with the company, for any tax liabilities with regard to VAT and withholding taxes.

3. The right to claim and the capacity to be made a defendant

a. Before bankruptcy

Before bankruptcy, primarily the company itself has the right to claim against the directors or officers, whereas the decision lies basically in the competence of the board of directors. Therefore the general assembly would have to exchange the board of directors before claiming against the majority of the board of directors. According to article 693 para. 3 Ziff. 4 CO in connection with article 716a para. 1 Ziff. 6 CO, the general assembly could make a decision to claim against their own board of directors and the board of directors would have to implement this decision. If the board of directors remains inactive, the shareholders have to bring up a derivative suit. Claims of the company against the board of directors or officers are very rare in Switzerland.

In case of indirect damage shareholders can also claim against the directors and officers outside bankruptcy (article 756 para. 1 CO). In case of direct damage shareholders can claim against the involved directors or officers based on a breach of article 41 CO, *culpa in contrahendo* or aroused faith, but these claims outside bankruptcy are also very rare in Switzerland.

Before bankruptcy is declared upon a company, the creditors of a company have in default of damage no right to claim. In case of direct damage by a director or officer claims out of article 41 CO, *culpa in contrahendo* or aroused faith are possible, but the creditors will prefer to hold upon the financially strong company.

b. After bankruptcy

Once a company is declared bankrupt, there is only a uniform right to claim out of the collectivity of the shareholders according to the jurisdiction of the federal court.

Every creditor has the right to demand the assignment of those claims of the estate that the collectivity of the creditors does not want to assert (article 260 of the law of execution and insolvency). If the demand was admitted rightly cannot be checked in a process of liability. The formal position as creditor after assignation according to article 260 of the law of execution and insolvency in connection with article 757 CO is sufficient for an interest for legal protection and the right to claim in a process of liability, and the effective suitor can realize a process achievement for the admitted demand in advance.

The federal court limits the right to claim only in such cases where the individual claims of a creditor or shareholder could come into competition with the claims of the company, that means in those cases, where there is a direct damage of the creditor and the company at the same time. The creditor's right to claim has to stand back with regard to the company's right to claim to the extend the company is damaged itself if there is only a direct damage of the creditor, but no damage of the company.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

4. General

In Switzerland, the purchase of insurance to cover the liabilities of directors and officers is voluntary but not compulsory. There are different insurance companies which offer insurance coverage. The D&O is usually purchased locally and not from markets abroad.

In case of the classical D&O, the company and not the director or officer itself is the policy holder. All persons empowered to represent the company may, in the name of the company, perform all legal acts that may arise within the company's purpose (article 718a CO). The directors and officers are empowered to close a D&O policy for the company. In general, they are registered in the commercial register, and therefore empowered to validly bind the company (article 718 and 718a CO). The granted insurance coverage however protects the assets of the insured directors and officers, and not the assets of the company which pays the premiums.

There are some general principles in almost all D&O policies. One is the so called "claims made"-principle, meaning that there is insurance cover only for claims being made during the period of the contract of insurance. The insured person may be entitled to costs for defence and recovery, and is certainly entitled to claim indemnification from the insurer, which will most likely pay directly to the aggrieved party. The right of indemnification includes the duty to relieve the insured person from claims which could not be defended successfully. In all policies, the insurer is given the right to negotiate with the injured, including out of court settlements, instructions to lawyers in case of a litigation. The majority of the currently offered D&O policies exclude the granting of passive remedy. By doing this, the right of exemption is reduced to a pecuniary claim.

The insured person has a disclosure duty and an obligation to co-operate in case of a claim. The insured person is not allowed to accept any statutory duty or liability.

There are different kinds of insurances for the bodies of a company. There is either individual insurance or collective insurance. There is an individually definable insurance sum, and an all-including insurance amount. The insurance cover is in-dependent of the existence of the company.

5. The extent of cover

Insured is the liability to which the insured person is exposed in his/her position and function as a formal or virtual body of the incorporated company. Insured are therefore claims, based on D&O liability.

The D&O insurance provides only cover for pecuniary loss. There is no cover for injury to persons or damage to property. Furthermore, claims in case of offence or crime are normally excluded from the coverage, as well as claims under public law.

6. Indemnification

If there are no specific restrictions of coverage in the insurance policy regarding claims of the company against its own directors and officers, there is another specialty of the D&O insurance: Damages, which the company as policy holder suffers by a misconduct of a director or officer are in principle covered, although they are strictly speaking own damages of the company. Such damages are normally not covered by liability insurances. Another specialty of the D&O policy is that the insurance company, insofar as it has a duty to defend an insured director or officer, represents these persons against the company in a legal dispute, although the company is the policy holder and premium payer. Such claims are very rare in Switzerland, as long as the company has not yet gone bankrupt. In case of bankruptcy, however, it is possible that the bankruptcy estate to fight for indemnification against the insurer.

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Switzerland 2

LARS GERSPACHER, GERSPACHER BÜHLMANN FANKHAUSER

Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

Article 754 of the Swiss Code of Obligations ("CO") sets out that the members of the board of directors and all persons engaged in the management or liquidation of a company are liable for the damage caused by an intentional or negligent violation of their duties. It covers not only those directors or managers which are registered in the commercial register but also those which effectively and decisively exert on the company's decisions (so called de facto organs).

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The board of directors shall manage the business of the company (Article 716 [2] CO). However, the shareholders may authorize the board of directors in the articles of incorporation to fully or partially delegate the management to individual members or third parties in accordance with the by-laws (Article 716b [1] CO).

The members of the board of directors as well as third parties being engaged with the management shall carry out their duties with due care and shall duly protect the interests of the company (Article 717 [1] CO). How-ever, the following duties of the board of directors are non-transferable: the ultimate management of the company, the establishment of the organisation, the structuring of the accounting system and of the financial controls as well as the financial planning, the appointment and removal of the persons entrusted with the management, the ultimate supervision of the management, the preparation of the business report and the general assembly of the shareholders, and the notification of the judge in the event of over-indebtedness (Article 716a CO).

Where the board of directors has rightfully delegated its duties to the management the directors are still liable for any damage caused by the management unless they can prove that they have applied the necessary care in selection, instruction and supervision under the given circumstances (Article 754 [2] CO).

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The directors and officers shall give equal treatment to shareholders under equal circumstances (Article 717 [2] CO). The liability of directors and officers under Article 754 CO is owed not only to the company but also to each shareholder.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers represent and act in the name of the company. In principle, they may only face direct claims if they are liable for tortious acts and omissions (Article 41 et seq. CO and Article 55 [3] of the Swiss Civil Code).

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

There are a number of criminal offences in connection with the management of a company provided by the Swiss Penal Code. To name a few: false statements about commercial enterprises (Article 152), disloyal management (Article 158), exploitation of knowledge of confidential facts (Article 161), fraudulent bankruptcy (Article 163), harming creditors by diminishing assets (Article 164) or mismanagement (Article 165).

It is also worth pointing out that, based on Article 52 of the Swiss Federal Act on the Federal Social Security Fund and the respective long-lasting practice of the courts, directors are personally, severally and jointly liable for social contributions which have not been paid by the company.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers represent and act in the name of the company. Employees could personally sue a director or officer if their wrongful act also caused tortious liability.

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

The directors and officers would not have further liabilities towards the trustees other than to the company itself.

8. What remedies are available?

If the requirements of Article 754 CO are met a director or officer may be awarded to pay damages. If the director or officer also committed a crime, he or she may be punished with imprisonment or fines (see above).

9. Who has the right to claim?

In addition to the company, each shareholder is entitled to file an action for damage caused to the company. Any claim of the shareholder is, however, for performance to the company (Article 756 [1] CO).

In the event that the company is bankrupt and the trustee in bankruptcy waives its right to assert the claims against the liable directors and officers, the shareholders and the creditors of the company are also entitled to re-quest that the damage to the company be compensated (Article 757 [1] CO). If the shareholder and/or the creditors succeed, such compensation will cover their damage first. Any surplus will then go the bankrupt estate (Article 757 [2] CO).

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

There is no provision under Swiss law which deals with D&O insurance. The purchase of D&O insurance is common practice in Switzerland. Such insurance can be bought by the director, the company itself, the shareholders or one of the group companies. The usual concept is that policyholder is one of the group companies or the company itself and the directors and officers of the company are insureds (i.e. buying insurance for the benefit of third parties).

11. Are there any corporate procedural prerequisites to effecting cover?

No, but the application must be duly signed by representatives of the policyholder.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

Prior to the policy becoming binding, pursuant to Article 4 of the Insurance Contract Act ("ICA") the policyholder and the insured shall give proper and accurate answers to the questions posed by the insurer in a questionnaire as long as the questions are material to the risk and relevant for the specific extent of cover, the premium and the applicable conditions. Beyond the questionnaire there is no general duty of utmost good faith.

13. Are there any tax implications connected to the purchase of D&O cover?

On the purchase of insurance there is a stamp duty of 5 % on the payable premium. Such duty has to be paid by the policyholder, i.e. in most cases the company.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

No.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

For D&O insurance the insurer must be admitted in Switzerland at least through a locally registered branch. In that respect, D&O insurance is always purchased locally.

It is common to obtain reinsurance protection from overseas market but the local reinsurance market provides reinsurance protection for that line of business as well.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

Usually, insureds are the individual directors and officers as well as those individuals who effectively and decisively exert on the company's decisions (de facto organs).

Some policies do contain a company reimbursement cover where the company has indemnified its directors and officers based on a legal, statutory or contractual duty. Such indemnity is not permitted in all cases (see Question 21).

17. What is commonly covered?

D&O insurance in Switzerland commonly covers any liabilities incurred by directors, officers and de facto organs in their capacity as organs. Cover also includes defence costs and the sums awarded by a competent court or tribunal as damages. Claims made by major shareholders

are commonly covered as well. As there is a tax liability of each director for those social contributions which have not been paid by the bankrupt company, D&O insurance normally covers taxes as well.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Fines or penalties are commonly excluded. It would also be prohibited by law to purchase such cover. Indemnities of punitive or exemplary character are normally excluded as well. The same holds true for dishonest or fraudulent acts or omissions and losses attributable to the organ's unlawful profit or financial advantage. Some insurance policies further exclude cover for claims in connection with environmental damages.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Claims could be brought by the insureds (i.e. the individual directors, officers and de facto organs) or the policyholder for the benefit of the insureds. Where the company lawfully reimburses its directors the company will have its own cover und the Company Reimbursement Cover regime.

20. What is the procedure for bringing a claim?

D&O policies written in Switzerland do commonly contain a maximum notification period within which a claim must be notified to insurers. The majority of policies do, however, not entitle insurers to refuse to meet the claim if the insured fails to notify them in time. Rather, the insurer is entitled to reduce the indemnity insofar as a timely notification would have caused a lower loss (Article 38 [2] ICA).

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Indemnification agreements between the company and its directors and officers have been discussed controversially in Switzerland. The provisions in Article 754 et seq. CO encompassing the liability of the company's organs are mandatory. An indemnification agreement between the company and its own directors and offices would circumvent the mandatory rules and, therefore, most likely be regarded as invalid. That situation may also arise where the company as policyholder is obliged to pay for the deductibles.

22. How is the indemnification dealt with in practice?

As indemnification agreements between the company and directors and officers are problematic it is more common to have indemnification agreements between the parent company (or the shareholders) and the directors and officers of the affiliate. Such agreement would not be in breach of Article 754 et seq. CO.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

As mentioned above, the articles of incorporation may authorize the board of directors to fully or partially delegate the management to individual members or third parties based on by-laws (Article 716b [1] CO). This is of-ten used for board of directors with members who mainly fulfil a supervisory duty.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

No, but it is worthwhile mentioning that disputes in Switzerland between insureds/policyholders and insurers almost always relate to the exact meaning of clauses dealing with series of losses.

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Taiwan

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

In general, "Directors and Officers" implies the "Responsible Persons" of a company which means shareholders conducting the business or representing the company in the case of an unlimited company or unlimited company with limited liability shareholders, and the directors of the company in the case of a limited company or a company limited by shares. The managerial officer or liquidator of a company, the promoter, supervisor, inspector, reorganizer or reorganization supervisor of a company limited by shares acting within the scope of their duties, are also responsible persons of a company (Article 8 of the Company Law).

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In general, responsible persons of Taiwan corporations have four principal duties to the corporation as follows: the duty of loyalty, the duty of care, the duty of non-competition and the duty of conducting business in accordance with laws and regulations, the Articles of Incorporation, and the resolutions adopted at the shareholders' meeting (Article 23, 193 and 209 of the Company Law).

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In general, the responsible persons of Taiwan corporations are responsible to the company instead of the shareholders. However, the shareholders may exercise shareholders' right in accordance with relevant laws and regulations by requesting the responsible person of the company such as directors or supervisors to call an extraordinary shareholders' meeting or request the Board of Directors to discontinue any infringement. In certain circumstances shareholders holding 3% or more of the total share capital may request a court to remove a director or supervisor who has engaged in acts which may materially damage the company or material matters which violate the laws and regulations or the Articles of Association. Shareholders holding 3% or more than 3% of the issued share may also in certain circumstances request supervisors in writing to bring litigation against the directors, or to the Board of Directors to bring litigation against the supervisors, and if the supervisors or the Board of Directors, as the case may be, fail to do so within thirty(30) days, the shareholders may also bring the litigation on behalf of the company (Article 173, 94, 200, 214 and 227 of the Company Law).

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In general, in the event that a responsible person's carrying out the company's responsibilities is in violation of applicable laws, and such violation results in loss to another person, such responsible person shall be jointly and severally liable with the company with respect to such loss (Article 23 of the Company Law).

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In practice, the most common criminal and regulatory liabilities of the Directors and Officers are:

Criminal liabilities:

According to the Labor Safety and Health Act, if the responsible person who is actually involved in the execution of company business operation fails to provide necessary safety and sanitation equipment and measures, safety and sanitation management or a safe working environment for the workers according to relevant laws and regulations and as a consequence an occupational accident occurs which causes injuries to three or more workers or any death, the responsible person shall be liable for relevant criminal liabilities. When the company's performing its business leads to injuries or death to others, in addition to the fact that the actual doer shall be responsible therefore, the responsible person of the company may also be responsible for the criminal liabilities.

Regulatory duties:

According to Article 15 of the Administrative Penalty Act, where the act of a director or any other representative of a company, in performance of his duties as such or for the benefit of the company, results in breach of duty under administrative law, thereby making the company punishable, the director shall likewise be subject to pay a similar amount of fine under the provisions applicable to the company if such director has acted with intention or in gross negligence, unless the law or the self-governing ordinance provides otherwise.

Where the act of any staff member, employee or worker of a company in performance of his duties or for the benefit of the company results in breach of duty under administrative law, thereby making the company punishable, and the director of such company or any other representative of a company fails to perform his duties to prevent the occurrence of such act in breach of duty under administrative law because of his intention or gross negligence, such director and individual shall likewise be subject to pay a similar amount of fine under the provisions applicable to the company, unless it is otherwise provided by law or by self-governing ordinances.

In addition, according to the Administrative Execution Act, if the company (i) fails to perform duties of monetary payment stipulated in the public law according to relevant laws or regulatory actions or court ruling when due, (ii) intentionally fails to perform legally required duties, or (iii) assets required to be compulsorily executed are concealed or disposed, then although the obligor is the company, the responsible person of such company may be summoned to the court, be required to pay the payable amount, or be ordered to report the status of assets of the company, or even ordered to be confined in prison.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Except for the general provision that in the event that the responsible person of a company has, in the course of conducting the business operations, violated any provision of the applicable laws and/or regulations and thus caused damage to any other person, the responsible person shall be liable, jointly and severally, for the damage to such other person, there are no other specific laws or regulations in Taiwan regarding duties of the Directors and Officers to employees

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In accordance with the Bankruptcy Act of the R.O.C., a director of a company or certain other persons in a comparable position and the managers or the liquidators will be subject to imprisonment of from less than one(1) year to less than five(5) years, in the event he or she engages in any of the following acts:

- during the bankruptcy procedure, he or she refuses to submit a status description of the company's assets and the detailed lists of the company's creditors and debtors, or intentionally omits to include assets in the description;
- he or she refuses to deliver all books and documents related to the company's assets and all assets under the company's control to the bankruptcy trustee;
- he or she fails to provide explanation or response or makes fraudulent statements to inquiries related to assets and business from bankruptcy trustee or supervisor or at the creditors' meeting;
- prior to one(1) year to the announcement of bankruptcy or during the bankruptcy procedure, for the purpose of causing damage to the creditors, he or she makes a disposal of assets unfavourable to the creditors, destroys or fabricates account books or the whole or a part of other accounting documents, or destroys or fabricates accounting documents causing the asset status to be inaccurate;
- prior to one(1) year to the announcement of the bankruptcy, he or she engages in acts of waste, gambling or other opportunism, causing the assets to decrease or the company to become liable for excessive debts.

8. What remedies are available?

Award of monetary payment.

9. Who has the right to claim?

Companies, shareholder, directors, supervisors, employees, third parties, liquidators, etc..

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

Purchase of D&O policy is legal and is an act encouraged by the competent authorities (purchase of D&O policy is included in the Best Practice Principles of Corporate Governance for listed, OTC companies, banks, insurance companies, bill finance companies, and securities firms). In practice, either limited company or company limited by shares could purchase D&O policies.

11. Are there any corporate procedural prerequisites to effecting cover?

The company may purchase D&O policy for the directors and supervisors in accordance with the Articles of Incorporation or resolutions adopted at the shareholders' meeting.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

As a proposer, the insured company is generally required to provide the following information regarding itself and the insured D&O (if applicable) to the insurer prior to commencement of cover: basic information; organizational structure; annual reports and audit reports prepared by a CPA for the past three(3) years; nature of business; whether it has previously merged with other companies before; or has future or on-going merger or equity acquisition plan (or being merged or equity acquisition plan); whether or not it has any plan to sell or wind up business; capital structure; equity structure; equity transaction mode; past experience of purchasing D&O policies; whether such D&O policy has made claims for damages; whether it has been or may be punished with a fine or has been or may be investigated, requested for compensation, levied a fine or involved in any investigation. If the insured company or the insured intentionally conceals, wilfully omits or makes a false statement, the insurance contract normally provides that the insurer is entitled to terminate the contract.

13. Are there any tax implications connected to the purchase of D&O cover?

Generally speaking, the insurance premium for D&O policies could be recognized and entered in the account book as an expense. If insurance payment is received, depending on the situation, it may be considered as income of the company or the directors or supervisors and will be levied relevant consolidated income tax or business tax.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

D&O cover is not compulsory in Taiwan.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

Locally.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

In Taiwan, the insured persons under a D&O policy will commonly include the individual directors, supervisors and officers, outside entity executive, employee of the company while acting in a managerial or supervisory capacity for the company excluding liquidator, administrator or receiver appointed by a court, external auditor.

17. What is commonly covered?

In general, D&O insurance in Taiwan will cover damages and loss arising from or a consequence of any claim against directors and officers during the period of insurance by reason of a wrongful act. In most cases cover will extend to the investigation costs arising from or a consequence of a formal criminal, administrative or regulatory investigation, hearing or enquiry, commenced by any regulator, government body, government agency or official trade body into the affairs of the company and prosecution costs to defend proceedings.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Normally D&O will exclude coverage of loss due to intentional dishonest or fraudulent act committed by the insured, having gained any personal profit to which such insured was not legally entitled, as well as losses incurred due to pollution, nuclear radiation or radioactive dangerous substances.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

Claims in the Taiwan can be brought by the company and/or the directors and officers.

20. What is the procedure for bringing a claim?

D&O policies written in Taiwan will commonly set a period of time which is allowed to elapse between an insured becoming aware of a claim and that claim being notified to insurers; further more, the insurer shall have the right to be provided with all such information concerning such claim and shall be kept fully informed as to all matters relating to the claim.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

There are no rules in Taiwan which prohibit the company from indemnifying the responsible persons. However, it worth noting that if the board of directors resolves to compensate the responsible persons (or replace the responsible persons to be responsible for compensation of damages of the third party), the directors who are in favour of this resolution may instead be considered to have failed the exercise of due care as a good manager, and cause damage to the company, therefore could be liable for damage compensation to the company in accordance with law.

22. How is the indemnification dealt with in practice?

There is no consistent practice in this regard and is dealt with on a case by case basis.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

The Corporate Governance Best-Practice Principles for listed and OTC companies, banks, insurance companies, bills finance, securities firms all provide that the company may purchase liability insurance for directors and supervisors, but such provision is not compulsory.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

No.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

No.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

No.

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United States of America 1

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Form and nature of liabilities to which corporate representatives are exposed

1. Who are considered to be responsible directors and officers?

In the U.S., all corporate directors and officers may be named in a litigation; "defendants" need not be the individual directors and officers actively involved in the corporate operations. As far of coverage, a D&O policy may name numerous persons and entities as "insureds" under the policy. For example, a D&O policy may define "Insured Persons" to include former, current and future directors, officers and trustees; lawful spouses of Insured Persons; directors and officers serving in outside directorship capacities; or past, present and future employees of the company as to certain types of claims such as employment-related claims (i.e., discrimination, Sarbanes-Oxley and retaliation claims). A D&O policy may also broadly define "Insured Organization" to include the business entity and any of its subsidiaries and affiliates. Thus, there are many different persons or entities that may be entitled to coverage under a single D&O policy in connection with a particular claim.

2. What are the duties/liabilities of directors and officers to the company?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

In the United States, there are a number of different states and federal regulations detailing the duties and liabilities of directors and officers to a company. Moreover, state and federal law imposes a number of specialized requirements for directors and officers in highly-regulated industries, such as insurance, banking and health care. A comprehensive summary of each of these laws would exceed the scope of this study.

Traditionally, however, directors' and officers' fiduciary duties have been understood as follows: (1) duty of care: requires deliberative decision-making processes based on full and credible information; (2) duty of loyalty: prohibits self dealing, misappropriation of corporate assets, conflicts of interest, lack of independence or disloyal conduct; and (3) duty of good faith: forbids conduct motivated by an actual intent to impede, interfere with or harm the company, or violate the law.

Courts have, however, developed a corresponding "business judgment rule" to protect directors and officers. This rule codifies a presumption that the directors acted on an informed basis, in good faith and in honest belief that the action was taken in the best interest of the company.

3. What are the duties/liabilities of directors and officers to the shareholders?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers owe the same fiduciary duty to shareholders, as it does to the company.

4. What are the duties/liabilities of directors and officers to third parties (i.e. persons not directly connected with the company itself)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers do not owe any duty to persons not connected with the company.

5. What are the duties/liabilities of directors and officers to the state (i.e. criminal or regulatory liability)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

As noted in our response to Request 2, state and federal laws impose various duties and requirements upon directors and officers. Specifically, the federal securities law (i.e., Securities Act of 1933 and Securities Exchange Act of 1934) impose upon the company and its directors and officers very specific reporting requirements, and allow shareholders and investors causes of action for breach of these obligations. The Securities Act generally requires companies and its directors and officer to give investors "full disclosure" of all "material facts," the facts investors would find important in making an investment decision. This Act also requires filing of e a registration statement with the SEC that includes information for investors. The Exchange Act requires publicly held companies to disclose information continually about their business operations, financial conditions, and managements. These companies, and their officers and directors, must file periodic reports or other disclosure documents with the SEC. In some cases, the company must deliver the information directly to investors.

6. What are the duties/liabilities of directors and officers to employees?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

More than half of the states in the U.S. have passed "stakeholder" laws, which permit (and in some very limited cases "require") directors and officers to consider the impact of their actions upon constituencies other than shareholders, like employees. Typically, these statutes apply generally to decisions related to tenders, mergers and consolidations. Most state laws of this kind do not mandate constituency-based decision-making, but merely permit these provisions to be adopted by the corporation with shareholders' approval.

For example, N.Y. Bus. Corp. Law § 717(b) allow directors and officer to take into consideration constituencies other than shareholders, including employees. The NY statute is permissive and does not give employees standing to sue. It should be noted, however, that an employee (regardless of the permissive nature of any state statute) could bring a claim against a director or officer for mismanagement or misuse of retirement or benefit funds, under Federal laws. However, it is fairly common for D&O policies to contain exclusions for claims arising out of the insured's role as an trustee or similar plan manager under the Employee Retirement Income Security Act of 1974 ("ERISA" - as this act is called - is a federal statute that establishes minimum standards for pension plans in private industry and provides for extensive rules on the federal income tax effects of transactions associated with employee benefit plans. ERISA was enacted to protect the interests of employee benefit plan participants and their beneficiaries by requiring the disclosure to them of financial and other information concerning the plan; by establishing standards of conduct for plan fiduciaries; and by providing for appropriate remedies and access to the federal courts.)

7. What are the liabilities of directors and officers to any trustees in bankruptcy (e.g., administrator/liquidator)?

(a) at common law;

(b) under legislation; and

(c) under regulations

Are there any exemptions from or limitations on liability?

Directors and officers owe the same fiduciary duties of care and loyalty to trustees in bankruptcy as they owe to the shareholders and the solvent company.

8. What remedies are available?

A party may seek damages, fines, fees, interest and penalties (including punitive damages) against the directors and officers for breach of a specific duty. In bankruptcy, under the theory of deepening insolvency, damages are measured by the dissipation of corporate assets and/or the company's increased debt load. Thus, a court could award damages that reflect the full value of assets sold or additional loans obtained irrespective of the amounts or benefits actually received by the alleged wrongdoers.

9. Who has the right to claim?

Generally, shareholders, company and/or the SEC may assert claims against the directors and officers for breach of a duty or violation of the securities law. Certain state laws give state regulators a right of action against directors and officers. In bankruptcy, a Trustee, on behalf of the company, may file claim against the directors and officers for breach of their fiduciary duties.

INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Insurance

General

10. Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it?

The purchase of D&O cover is legal. A company can buy D&O cover to protect the personal assets of directors and officers and to meet their legal costs. The policy will reimburse the individual for personal liability arising out of "wrongful acts". Alternatively, the policy can compensate the company itself where it has reimbursed a director or officer for a personal liability arising out of "wrongful acts". The policy usually does not cover pension trustee liability (which can be insured separately), fraud and dishonest acts (covered by Fidelity insurance), and Employers Liability.

11. Are there any corporate procedural prerequisites to effecting cover?

The decision to purchase D&O cover is made by the company's Board of Directors.

12. What disclosure is required to be given by the directors and officers prior to commencement of cover to:

(a) the company or any organ of the company; and

(b) to insurers?

A director and officer must disclose to the company all of his/her interests which may potentially conflict with his/her duties and obligations to the company, as well as all acts and occurrences which may give rise to a potential claim. As to insurers, the company and its directors and officers are required to disclose all facts known to the insured which are material to the risk and which it is reasonable to assume that the insurer will want to take into account in determining whether or not to provide cover. Generally, an insurer will rescind a policy if it discovers a material misrepresentation on the application. The definition of "application" can include not only the insurer's form and materials submitted with that form (e.g., financial statements), but also the company's public filings, press releases and other statements. An insurer may rescind the entire policy because of a misrepresentation.

13. Are there any tax implications connected to the purchase of D&O cover?

There are no tax implications connected to the purchase of D&O cover.

14. Is insurance of D&O exposures compulsory in respect of any type of company?

The purchase of D&O cover is not mandatory.

15. Is D&O insurance usually purchased locally or purchased from overseas markets?

The U.S. is a strong market for direct D&O insurance coverage. However, there is an available supply of reinsurance is limited. Thus, most locally purchased policies will be reinsurance in the London Market.

THE EXTENT OF COVER

16. Who are the beneficiaries of the insurance?

A typical D&O policy provides coverage for individual directors and officers as well as for the organization when it indemnifies those individuals. Some D&O policies also provide a third type of coverage—what is commonly referred to as "entity coverage" or "enterprise coverage." "Entity coverage" applies to claims against the entity itself—independent of the individuals. This coverage usually applies to employment-related claims including alleged discrimination.

17. What is commonly covered?

D&O policies typically provide legal defence coverage, as well as indemnification of damages. These policies include protection for claims against individuals for mismanagement of a business. Reimbursement would be provided for certain securities and other federal law claims, subject to various "conduct" exclusions.

18. What is commonly excluded?

(a) because the purchase of cover is prohibited; or

(b) as a matter of common practice?

Public policy may preclude indemnification against claims under the registration and anti-fraud provisions of the federal securities laws. As Congress intended personal liability as a deterrent, the SEC's long-standing view is that such indemnification is against public policy and unenforceable.

BRINGING A CLAIM UNDER THE INSURANCE

19. Who can bring a claim under the D&O cover?

A "claim" can be brought by any "insured" under the D&O policy, which may include the individual directors and officers, the company or trustee in bankruptcy.

20. What is the procedure for bringing a claim?

D&O policies usually detail the procedure for notice to insurers, and define what constitutes a "claim". In New York, for example, insurers are required to show prejudice for a late notice defence.

INDEMNIFICATION

21. Can the company indemnify its directors and officers? If so, for what?

Generally, a company can indemnify its directors and officers for liabilities arising from a "wrongful act". However, a company may not indemnify its directors or officers where either (1) the company is prohibited by law from doing so (i.e., personal liability intended as a deterrent); (2) the company's bylaws or Board does not allow it to do so; or (3) the company is financially incapable of doing so, due to bankruptcy, liquidation, or lack of funds.

22. How is the indemnification dealt with in practice?

Companies may indemnify their directors and officers to the fullest extent permissible in law.

ANY OTHER BUSINESS

23. To what extent is corporate governance utilised to shield directors and officers?

Business judgment rule is a legal principle that makes directors and officers immune from liability to the company for loss incurred in corporate transactions that are within their authority and power to make when sufficient evidence demonstrates that the transactions were made in good faith.

24. Are there any anticipated legislative/regulatory changes to the extent of directors' and officers' liabilities?

On July 1, 2009, the SEC voted on three measures that are intended to better inform and empower investors to improve corporate governance and help restore investor confidence. The Commission proposed requiring public companies receiving money from the Troubled Asset Relief Program (TARP) to provide a shareholder vote on executive pay in their proxy solicitations. The Commission also voted to propose better disclosure of executive compensation at public companies in their proxy statements, and approved a New York Stock Exchange rule change to prohibit brokers from voting proxies in corporate elections without instructions from their customers.

25. Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification?

There are no anticipated legislative or regulatory changes that would impact the cover.

26. Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

In August 2007, the NYS Insurance Department issued an Office of the General Counsel Opinion on the "Duty to Defend" under D&O policies. In brief, the opinion states that a D&O policy cannot include a provision that places the duty to defend upon the insured, rather than the insurer. In response to industry backlash, the Department recently circulated a draft of the regulatory proposal clarifying its decision, and inviting the members of the Professional Liability Underwriting Society ("PLUS") to comment on the draft. PLUS is now compiling comments

and plans to share them with the American Insurance Association and the NYS Insurance Department.

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Liability Risks for Private Equity and Venture Capital General Partners serving as Portfolio Company Directors

I. Introduction

One question posed by the IBA Insurance Committee Substantive Project 2009 was "What are the liabilities of Directors and Officers to shareholders?" Given the Project's broader focus on the effect upon D&O cover of the global financial meltdown, one particularly interesting area for consideration in the United States is the liability to portfolio company shareholders of private equity and venture capital general partners serving as portfolio company directors.

During difficult economic times such as these, private equity and venture capital firms and their general partners face potential claims from their own fund investors in the somewhat likely event of underperformance by the funds' investments. However, whereas these risks can be tempered by appropriate drafting of investment agreements and related documents, another significant risk for private equity and venture capital firms in a down economy cannot be so easily mitigated: claims from shareholders in the portfolio companies in which the firms' funds invest.

In the event that a portfolio company of a private equity or venture capital fund files for bankruptcy, the private equity and venture capital firms and their general partners face potential exposure to the portfolio company's shareholders and bondholders and to the company itself, in the person of a bankruptcy trustee. The prevailing risk of such claims is of course exacerbated when potential portfolio companies are failing in ever increasing numbers. In the current economic environment, therefore, where some commentators have predicted that as many as 100 portfolio companies previously valued at over $100 million could fail in the next year, such risk is particularly acute.

II. Background: Strategic Development of Portfolio Company Investments

Once a private equity or venture capital fund has chosen a portfolio company in which to invest, the general partners of the fund spend their time working with the fund's portfolio companies to increase their value. In connection with its investments, the private equity/venture capital fund, through its general partners, often places a representative on the Board of Directors of the portfolio company. As a Board member, this representative offers strategic advice to the portfolio company's management and assures that the private equity or venture capital fund's interests are considered.

Because of competition among venture capital/private equity funds for promising portfolio company investments, venture capital and private equity firms have developed specialized investment strategies that concentrate on specific industries in particular stages of corporate development. Usually, the focus on a particular industry reflects the experience of the general partners of the venture capital or private equity fund. This experience makes the general partner a potential valuable addition to the Board of Directors of potential portfolio companies in that industry. Popular areas of expertise in the venture capital/private equity industry include e-commerce, web content, biotechnology, computer software, communications, retail and other specialty niche areas.

What differentiates private equity and venture capital investors from passive investors (such as hedge funds or the typical individual investor) is a long-term involvement with their investments. As active Board participants, private equity and venture capital investors offer their unique set of experience and skills. Successful venture capital and private equity firms arrange for the long-term financing of their portfolio companies and aid in developing the management team, advisory boards, new product ideas, strategic relationships and key customers and accounts. With greater involvement, however, comes greater responsibility for the portfolio company's actions and greater risk in the event the portfolio company performs poorly.

III. The Issue: Risk Exposures to Private Equity and Venture Capital General Partners Serving as Portfolio Company Directors

General partners and their affiliated private equity and venture capital firms have been sued for fraud, breach of contract and securities law violations (federal and state) relating to the fund's investments in, or dealings with, portfolio companies. In these cases, plaintiffs allege that the fund, through its general partners, dominated or controlled the Board of Directors of the portfolio company and then abused that power for their own self-interest to the detriment of the portfolio company and its other shareholders.

The risk of these claims grows in proportion to the involvement of the private equity fund in the operations, management and financing of the portfolio company. This involvement is quite predictable because, as noted above, the funds promote it in attracting potential portfolio company investments.

When these claims are brought, individual general partners of the fund, as well as the venture capital and private equity firms by which they are employed are named as defendants. Joining these parties as defendants is justified on the basis that they are the ones who actually exercise the control, make the decisions and deal with the individuals who claim to have been damaged. Under various controlling person theories, these individuals face the same degree and magnitude of liability exposure as the private equity/venture capital firm itself.

A. Breach of Fiduciary Duty

As members of the portfolio company's Board of Directors, the private equity/venture capital fund's chosen representative(s) (general partner(s)) generally owes fiduciary duties of loyalty and due care to the portfolio company and its constituents. When the portfolio company is insolvent or in the "zone of insolvency," the creditors of the portfolio company are often treated as being within the group of constituents who are owed these fiduciary duties.

Although the general partner's actions as independent directors may be entitled to the protection of the business judgment rule[1], they will often be judged in hindsight by both the portfolio company's creditors and bankruptcy trustee and by the bankruptcy court.

Under such conditions, any perceived self-dealing or prioritization of the private equity fund's interest over the interests of the portfolio company (duty of loyalty) or lack of diligence in considering and making decisions as a Board member (duty of due care) will be judged harshly. This is of particular concern in the case of independent directors who are also private equity/venture capital firm general partners because: (1) general partners often serve as Board members of various portfolio companies, potentially creating the impression of a lack of due diligence as to any one company; and (2) general partner's dual roles as both independent directors and general partners with a fiduciary duty owed to the private equity/venture capital fund investors can often be manipulated, even in the absence of any specific evidence of a breach of duty, to create the impression of a conflict of interest.

B. Fraud and '33 Act Claims

In the context of an initial public offering and subsequent failure of a portfolio company, private equity and venture capital firms often face claims that they participated in issuing fraudulent offering materials that induced investors to purchase an interest in the company in the IPO. Although not particularly vulnerable to such claims over other directors, private equity/venture capital general partners and firms may be more attractive defendants in the current economic environment for the reasons discussed further below.

C. '34 Act Claims

Likewise, where investors have purchased shares on public exchanges purportedly in reliance upon financial reports or other releases by the portfolio company, private equity and venture capital general partners that were part of the portfolio company's Board of Directors at the time of the public statement are likely targets for claims should the company's stock subsequently perform poorly.

D. Breach of Contract

Where the private equity or venture capital fund has entered into an agreement concerning its investment in the portfolio company, it may also be exposed to claims of breach of contract to the other signatories to the agreement, including the portfolio company itself and/or other investors.

E. Fraudulent Conveyance

In the context of a bankrupt company, claims for fraudulent conveyance are also fairly common if the portfolio has made any payment or distribution while in the zone of insolvency or in bankruptcy. Such claims are subject to widely varying state laws and may have statutes of limitation as long as six years in certain cases.

IV. Conclusion: Why the Current Economic Environment Is Cause for Particular Concern

Private equity funds promote themselves to potential portfolio companies by the business experience of their general partners. The fund promises that if the start-up company accepts an investment from the fund, the fund will place a representative on its Board who can then help the portfolio company in a myriad of ways. If this aid does not lead to a successful public offering or sale of the portfolio company, however, the other constituents of the portfolio company, such as its founders or other shareholders, may then claim that the venture capital fund's assistance was merely designed to protect its own investment and not to advance the general interest of the portfolio company. Likewise, employees of the portfolio company may claim that adverse employment decisions involving them were the product of unfair and improper meddling in the portfolio company's business affairs by the venture capital fund.

The struggling economy and the evaporation of the credit market following the Lehman bankruptcy in September of 2008 produced challenges for private equity funds. The lack of abundant credit is forcing buy-out firms to do "all equity" deals, buy minority rather than controlling positions, and even request for seller financing. Conversely, due to the absence of a viable IPO market and the unwillingness of well-capitalized companies to spend their cash to buy portfolio companies, private equity firms increasingly must consider holding their portfolio investments longer than they would traditionally prefer and/or monetizing their investment in a portfolio company through a Chapter 11 proceeding. Here too, however, they find that Debtor-In-Possession and exit financing is now substantially more expensive (Libor plus 5-7%) over last year (Libor plus 2 ½%).

In 2008, 66 of the 105 major U.S. companies that filed for bankruptcy protection were either presently or formerly owned in whole or in part by private equity funds. Among the most notable portfolio company bankruptcies in 2008 were Linens 'N Things (a portfolio company of Apollo Management); Washington Mutual (TPG Capital); Mervyn's LLC (Sun Capital, Cerberus Capital); Powermate Corp. (Sun Capital); and Steve & Barry's LLC (TA Associates, Bay Harbor Asset Management). Commentators have already predicted that 2009 will bring the bankruptcy of more than 100 portfolio companies previously-valued at over $100 million dollars each. The potential for litigation against stakeholders in such companies should this take place is tremendous.

In addition, when considering who to sue in the context of an insolvent portfolio company, private equity and venture capital fund general partners and their firms make particularly attractive targets for creditors and bankruptcy trustees. After all, such firms are generally well-capitalized and claims against them and their general partners serving on a portfolio company board will generally implicate not only the directors and officers liability insurance coverage held by the portfolio company but also the venture capital asset protection coverage often held by the private equity firm.

Given these factors, should the rate of bankruptcy filings meet expectations in the coming year, a flood of litigation against private equity firms is almost inevitable.

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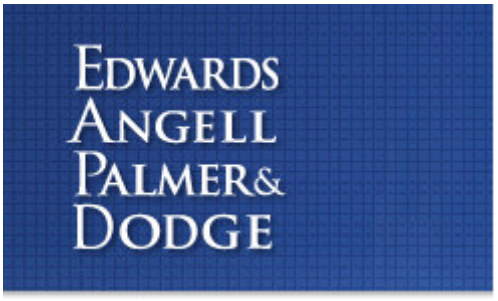

[1] In the case where the private equity or venture capital firm owns a majority stake in the portfolio company, the general partner's actions will not be protected by the business judgment rule.

Template

A COMPARATIVE ANALYSIS OF THE FORM AND NATURE OF LIABILITIES TO WHICH CORPORATE REPRESENTATIVES ARE EXPOSED AND THE INSURANCE AND INDEMNIFICATION PRODUCTS AVAILABLE TO COVER SUCH LIABILITIES

Responses to this document should be sent to Peter Taylor at Lovells LLP in London (Peter.Taylor@lovells.com) and Martin Manzano at Marval. O'Farrell & Mairal in Buenos Aires (mdm@marval.com.ar) by no later than 30 June 2009.

In a time of financial meltdown, those persons who represent large corporations, particularly quoted companies, find themselves in the spotlight of claims activity, as those who have lost money as a result of the corporation's activities (or inactivity) seek scapegoats and deep pockets from which to recoup their losses.

"D&O" or "Directors' and Officers'" liability coverage is one of the least well understood and, in many jurisdictions, under-developed, forms of insurance coverage.

The IBA Insurance Committee has undertaken to conduct a survey, the results of which are to be published in the course of 2009, in the form of a composite report including all suitable contributions. The subject is the extent to which the liabilities to which corporate representatives ("D&O", in insurance parlance) are exposed are adequately covered by insurance or other forms of indemnity in today's insurance market.

You are invited to proffer submissions of between 500-2,000 words encompassing some or all of the headings set out below.

	Form and Nature of Liabilities to which Corporate Representatives are Exposed
1.	Who are considered to be responsible Directors and Officers? For example Some jurisdictions include shadow directors and non-executive directors within the definition of "Directors and Officers" whilst some jurisdictions do not.
2.	What are the duties/liabilities of the Directors and Officers to the company? (a) At common law; (b) Under legislation; and (c) Under regulations. Are there any exemptions from or limitations on liability? For example In the UK, ss.171 to 177 of the Companies Act 2006 set out the general duties which directors owe to companies and which are derived from common law. These are to act within their powers, to promote the success of the company, to exercise independent judgement, to exercise reasonable care, skill and diligence, to avoid conflicts of interest, not to accept benefits from third parties and to declare any interest in proposed transactions and arrangements.
3.	What are the duties/liabilities of the Directors and Officers to shareholders? (a) At common law; (b) Under legislation; and (c) Under regulations. Are there any exemptions from or limitations on liability?

	For example In the UK, s.172 Companies Act 2006 requires directors to act in a way which will benefit the company's members (i.e. its shareholders) as a whole.
4.	What are the duties/liabilities of the Directors and Officers to third parties (i.e. persons not directly connected with the company itself)? (a) At common law; (b) Under legislation; and (c) Under regulations. Are there any exemptions from or limitations on liability? For example Directors of companies in the UK may face individual charges under the Health and Safety at Work Act 1974 where the business of the company is conducted in such a way as to expose third parties to risk to their health and safety.
5.	What are the duties/liabilities of the Directors and Officers to the State (i.e. criminal or regulatory liability)? (d) At common law; (e) Under legislation; and (f) Under regulations. Are there any exemptions from or limitations on liability? For Example The Corporate Manslaughter and Corporate Homicide Act 2007 in the UK provides that whilst a company can be convicted of corporate manslaughter or corporate homicide no individual liability will attach to its directors and officers under the Act.
6.	What are the duties/liabilities of the Directors and Officers to employees? (a) At common law; (b) Under legislation; an (c) Under regulations. Are there any exemptions from or limitations on liability? For Example Although, in the UK, directors are required to consider the interests of employees under s.172 Companies Act 2006 it is doubtful whether employees could personally sue a director as the directors principal duties are to the company.
7.	What are the liabilities of the Directors and Officers to any trustees in bankruptcy (e.g. administrator/liquidator)? (a) At common law;

	(b) Under legislation; and (c) Under regulations. Are there any exemptions from or limitations on liability? For Example Under the Insolvency Act 1986 a liquidator in the UK may apply to the Court for an order requiring a director to contribute to the company's assets if any business of the company has been carried out with the intent to defraud creditors.
8.	What remedies are available? For Example Awards of damages, fines etc.
9.	Who has the right to claim? For Example Companies, shareholders, employees, third parties, liquidators etc.

	Insurance and Indemnification Products Available to Cover such Liabilities
	Insurance
	General
10.	Is the purchase of insurance to cover the liabilities of the D&O legal and who may purchase it? For Example In the UK, s.233 of the Companies Act 2006 provides that it is legal for a company to purchase and maintain for a director of the company insurance against that director's liabilities.
11.	Are there any corporate procedural prerequisites to effecting cover? For Example Some jurisdictions require there to be a resolution of the Board of Directors prior to purchasing D&O cover.
12.	What disclosure is required to be given by the Directors and Officers prior to commencement of cover to:- (a) The company or any organ of the company; and (b) To insurers? For Example Insurance contracts in the UK are contracts of utmost good faith which impose an obligation upon a potential insured to give disclosure of certain facts to the insurer in advance of the policy becoming binding. In particular, the potential insured is required to give disclosure of all facts known to the insured which are material to the risk and which it is reasonable to assume that the insurer will want to take into account in determining whether or not to provide cover.

13.	Are there any tax implications connected to the purchase of D&O cover? For Example In some jurisdictions the purchase of D&O cover is regarded as a taxable benefit for the directors and officers of the company.
14.	Is insurance of D&O exposures compulsory in respect of any type of company? For Example D&O cover is compulsory in Romania for directors of joint stock companies.
15.	Is D&O insurance usually purchased locally or purchased from overseas markets? If insurance is purchased locally is it common to obtain reinsurance protection from an overseas market? For Example D&O insurance is more developed in the UK than in some European companies such that it is not unusual to see insurance purchased locally but reinsured into the London Market.
	The Extent of Cover
16.	Who are the beneficiaries of the insurance? For Example In the UK the insured under a D&O policy will be the individual directors and officers. It may also be possible to obtain Company Reimbursement Cover where the company is able to recover sums under the policy to the extent that it is required to reimburse its directors for claims made against them.
17.	What is commonly covered? For Example The purpose of D&O insurance in the UK is, in broad terms, to provide indemnity for liabilities incurred by directors and officers as a result of their acting in the course of the business of the company. In most cases cover will extend not only to the amount of any judgement or settlement, but also to the legal and certain other costs incurred by the insured individual in defending claims.
18.	What is commonly excluded? (a) Because the purchase of cover is prohibited; or (b) As a matter of common practice? For Example The Financial Services Authority in the UK prohibits the purchase of insurance cover in respect of payment of FSA fines.
	Bringing a Claim under the Insurance
19.	Who can bring a claim under the D&O cover? For Example Claims in the UK can only be brought by the policyholder who is commonly the individual directors and officers or the company.

20.	What is the procedure for bringing a claim? For Example D&O policies written in the UK will commonly set a maximum period which is allowed to elapse between an insured becoming aware of a claim and that claim being notified to insurers. Failure to meet this deadline will entitle the insurer to refuse to meet the claim.
	Indemnification
21.	Can the company indemnify its Directors and Officers? If so, for what? For Example Under s.232 Companies Act 2006 companies in the UK are prohibited from indemnifying their directors for liability which would ordinarily attach to directors save for as specifically provided for in ss.233-235 of the Act. Ss. 233-235 Companies Act 2006 permit companies in the UK to indemnify their directors in respect of their liabilities to third parties (with the exception of criminal fines and regulatory penalties) and to indemnify directors of a company that is a trustee of an occupational pension scheme against liability incurred in connection with the company's activities as trustee of the scheme.
22.	How is indemnification dealt with in practice? For Example It is relatively common in some jurisdictions for companies to indemnify their directors to the fullest extent permissible in law
	Any other Business
23.	To what extent is corporate governance utilised to shield Directors and Officers? For Example In Brazil the Sao Paulo Stock Exchange (BOVESPA) has instituted a scheme called "Novo Mercado" which provides for different levels of corporate governance to which subscribing companies are obliged to adhere.
24.	Are there any anticipated legislative/regulatory changes to the extent of Directors' and Officers' liabilities? For Example Are there any plans to codify directors' duties where no such codification currently exists.
25.	Are there any anticipated legislative/regulatory changes to the legality of insurance cover/indemnification? For Example Are there any plans to make D&O insurance cover illegal in respect of certain liabilities of directors such as the liability to pay criminal fines.
26.	Are there any particular areas/pitfalls to watch out for (i.e. horror stories)?

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