

Directors & Officers Insurance – key issues to consider

Directors of companies in the primary sector are contending with an increasingly regulated environment and greater risk of personal liability. All directors, whether of closely held family companies through to larger companies with broader shareholder bases, should have appropriate levels of directors and officers insurance.

Directors should obtain advice from an appropriately qualified insurance broker on the appropriate policy and levels of cover. In addition, there are a number of legal issues to consider.

Authority to obtain insurance

The company can only effect insurance for its directors and officers if it is authorised to do so by its constitution and has the prior approval of the board. Most standard constitutions will contain a provision authorising a company to affect directors and officers insurance for its directors, however, it is important to check this. It should also be noted that many smaller companies do not have a constitution.

In addition, directors who vote in favour of authorising the insurance must sign a certificate stating, in their opinion, the cost of effecting insurance is fair to the company. Where insurance is taken out for a director or employee of the company without a resolution and/or a certificate, or reasonable

grounds do not exist for the certificate, then the director may be personally liable to the company for the cost of the insurance.

What can the policy cover

Under section 162(5) of the Act the insurance can cover:

- liability (but not criminal liability) for any act or omission in his or her capacity as a director or employee;
- costs incurred by the director or employee in defending or settling any claim or proceedings relating to any such liability; and/or
- costs incurred by that director or employee in defending any criminal proceedings against the director or employee in their capacity as a director or employee and in which they have been acquitted.

Other key issues to consider

Most D&O policies include cover for directors and officers "investigation costs" incurred in responding to a regulator's investigation. This is an important provision as the company and/or directors can incur significant costs (including legal costs) responding to an investigation undertaken by a regulator before any action is taken or even if no action is taken.

Separate defence costs

As a result of the 2013 decision of the Supreme Court in the Steigrad case, recognising claimants rights to insurance proceeds ahead of the directors it has been necessary for directors to have separate defence costs insurance cover additional to D&O liability cover. As such, typically two policies are issued. The separate defence costs cover creates a separate pool which is not available to a claimant suing the director or officers of the company, which preserves their ability to fund the defence of the claim. This is also important because often director liability arises at a time the company is under financial pressure or has become insolvent, and would not be able to itself indemnify the director or officer facing a claim.

Directors & Officers Insurance – key issues to consider (Continued)

Capital raising

It is not uncommon for Agri companies, whether equity partnerships, Agri service companies or irrigation companies, to be regularly raising capital under the Financial Markets Conduct Act 2013 (whether by a Product Disclosure Statement (PDS) or in reliance on exclusion under the FMCA). Breach of this Act can give rise to civil and criminal liability for directors. Typically, most D&O policies will not cover such liability unless there is an express extension. Often with a significant capital raising it is necessary to obtain an extension to the policy or separate cover relating to the PDS.

Relationship between D&O policy and statutory liability

In addition to D&O insurance, it is advisable for the agribusiness and its directors to have in place separate statutory liability policy to cover statutory liability such as under the Resource Management Act and Health and Safety legislation. There can be an overlap and it is important to dovetail the policies. The policy will not cover fines, but will generally cover costs, investigations and liability for compensation or reparations.

Exclusions to watch out for

Often a D&O policy will have an exclusion for actions brought for and on behalf of major shareholders. Major shareholders are typically classified as shareholders holding 15% or more of the shares in the insured entity. With closely held companies, this may include all of the shareholders of the company, with a result that any action brought by any shareholder against the directors (often alongside a claim against the company) will not be covered by the policy. The reason for this exclusion is that shareholder claims are generally a result of a breakdown of relations either between shareholders or between shareholders and management, rather than being caused by governance or managerial errors involving substantive business decisions.

If, however, there is a reasonable level of independence at board level, it may be possible to negotiate a policy without this exclusion.

Another problematic exclusion that can arise is the exclusion of director liability arising as a result of the company's insolvency. This exclusion is problematic as often director liability arises after the company is insolvent with actions typically being brought by the liquidator in the company name (e.g. actions for reckless trading). New companies may struggle to avoid this exclusion but established companies with a good track record should be able to negotiate a policy without this exclusion.

Company indemnity

In addition to D&O insurance, section 162 of the Companies Act also deals with indemnities given by the company to the directors. This is not a form of insurance but rather an indemnity given by the company to the director or employee indemnifying them against a claim made against them in their capacity as a director or employee of the company. It is generally considered good practice to put in place an indemnity to provide some protection to directors and employees if the insurance policy does not respond. In the event, the indemnity is in place and the company pays out under the indemnity then the company will be able to claim under the D&O insurance policy. A D&O policy typically responds either to the company where it has paid out under an indemnity or covers the directors and officers directly where there is no indemnity, the company is insolvent, or the indemnity does not cover the claim.

An indemnity must also be authorised by the company's constitution.

Conclusion

Unfortunately, directors and officers insurance is a complex area. Insurance brokers are always careful to advise that they are not lawyers so it will be appropriate to obtain appropriate legal advice when taking out D&O policies or providing directors' indemnities to ensure that

Directors & Officers Insurance – key issues to consider
(Continued)

the insurance and indemnity have been validly issued.
Advice from broker and lawyer in combination should
ensure the right result is achieved.

Want to know more?

If you have any questions about Directors and Officers
Insurance, please contact our specialist [Rural and
Agribusiness](#) Team.