

## **Directors & Officers Liability Overview**

Litigation is a fact of life in South African business. The tough management decisions critical to success in a competitive business environment also carry the risk of unlimited financial liability for the both the company and its directors and officers.

Companies active in mergers, acquisitions or diversities are twice as likely to face at least one directors and officers liability insurance claim. This particularly relevant in South Africa where merger and acquisition activity has become a daily occurrence. Tighter South African regulation in a range of areas is fueling the growth on corporate litigation.

Expanding South African companies are exposed to the local jurisdiction of every country their products and services reach. This could mean a quantum leap in the likelihood and degree of financial risk in the U.S. In the case of Europe, EU directives will go even further making directors and officers jointly and severally liable for a breach by any one of them by placing the burden of proof on directors and officers rather than the individual bringing the action.

### **Where Liability Arises**

The personal liability of directors arises out of a breach of their duties as directors and offices. These duties reside in our common law and under statute and include the following:

- **Common Law**

On appointment, a director becomes a fiduciary in relation to the company and ads such is committed to recognise and enforce the common law fiduciary duties of good faith, care and skill and is obliged to:

- act in the best interests of the company
- exercise powers for the proper purpose
- disclose any conflict of interests
- refrain from making a secret profit

A breach in fiduciary duty renders the director personally liable for such breach.

## **Statute**

In addition to the common law fiduciary duties, the Companies Act of 2008 contains a number of provisions specifically designed to prevent and counter improper conduct by directors and officers. Most of these provisions carry the penalty of holding the director personally responsible for the misconduct.

## **Cover**

Directors' & Officers' (D&O) Liability Insurance is a contract of insurance designed to protect past, present and future D&O's by indemnifying them for loss resulting from an wrongful act, including errors or omissions for which the D&O is alleged to have committed in their capacity as a director or officer. The cover includes reimbursement for civil damages, defence costs, judgments, settlements and reimbursement to the D&O's company/employer for any indemnification to the director or officer for any such costs.

In addition, the D&O Liability package provides risk management support and legal help to identify problems and minimise their impact before they escalate beyond control. The policy will indemnify Directors and Officers of the company against any loss resulting from a wrongful act which they have committed or alleged to have committed.

These losses include:

- Civil Damages
- Legal costs as agreed with the insurer, which include costs of defending an action, cost awarded against a director
- Reimbursement to the company for loss suffered

## **Exclusions**

Many exclusions are negotiable and will vary from policy to policy. Generally most policies will exclude cover for:

- Libel, slander, bodily injury, sickness or death
- Pollution and environmental impairments
- A directors own fraud or dishonesty
- Fines, punitive damages, incidental breaches and claims between the directors themselves

### **Who Sues?**

- Shareholders generate litigation against directors and officers when they feel that share prices have dropped due to the negligence of a director or officer or because they purchased shares based on public statements made by directors or officers as to the company's financial strength or other aspects that may impact the decision to purchase shares.
- Employees may bring actions against directors and officers based on allegations of wrongful dismissal, harassment, discrimination or mismanagement arising out of the actions of directors or officers.
- Customers may also seek recovery for damages for losses arising out of the actions of directors or officers of your company. For example breach of contract.
- Competitors may bring actions against directors based on breach of trade practices.
- Government bodies may initiate actions against directors or officers to stop undesirable activity or recover damages on the part of the public. Remember, the allegations do not have to be true. The mere fact that allegations exist will result in significant defence expenditures on the part of the director or officer.
- Creditors have the right in terms of Section 424 of the South African Companies Act to bring action against a director for damages arising from the director's reckless or fraudulent actions.

### **When Are Claims Most Likely?**

- Mergers, Take-overs & Divestment experience has shown that at times of mergers and take-overs various groups of people tend to focus their attention on the affairs of the company. There are duties owed to existing shareholders, new shareholders, employees, suppliers, customers and the regulatory authorities and directors can be held personally liable when failing in their duties.
- Liquidation This obvious area is one many directors believe cannot happen to their company. Experience shows that even the strongest of companies can fail in difficult market conditions and the claims resulting from such failures can become lengthy, complex and expensive to defend.
- Employment Directors have been named in their personal capacity in civil actions for wrongful dismissal and age discrimination. In addition they have a legal obligation to every employee to ensure the efficient running of the company – mismanagement may lead to employees holding the directors personally liable for the failure of the company (who would suffer financially as a result of such failure).

- Creditors the directors and officer of companies who incur debts which they are unable to pay causing insolvency, may be held personally liable by creditors under s424 of the Companies Act which provides that any person who is knowingly a party to the carrying on of the business of a company in a reckless or fraudulent manner shall be personally responsible for all or any of the debts or other liability of the company. See *Philotex (Pty) Ltd v Snyman 1998*.