HANDLING "CROSS-BORDER" D&O AND E.P.L. CLAIMS INVOLVING CANADA AND THE UNITED STATES

Eric A. Dolden and Susan Rutherford

July 2001
(Updated 2014)

18th Floor - 609 Granville St.
Vancouver, BC
Canada, V7Y 1G5
Tel: 604.689.3222
Fax: 604.689.3777

308 - 3330 Richter Street
Kelowna, BC
Canada, V1W 4V5
Tel: 1.855.980.5580
Fax: 604.689.3777

850 - 355 4th Avenue SW
Calgary, AB
Canada, T2P 0J1
Tel: 1.587.480.4000
Fax: 1.587.475.2083

500 - 18 King Street East
Toronto, ON
Canada, M5C 1C4
Tel: 1.416.360.8331
Fax: 1.416.360.0146

CONTACT LAWYER

Eric Dolden

604.891.0350
edolden@dolden.com

TABLE OF CONTENTS

I. INTRODUCTION: KEY DIFFERENCES BETWEEN THE U.S. AND CANADA FOR THE D & O INSURER

As a result of the passage of legislation creating direct liability for directors and officers ("D & O's") in Canada, and as a result of increased Canadian corporate involvement in the U.S. money market, lawsuits against Canadian D & O's are increasing in both frequency and severity.[1] Canadian D & O exposures present a business opportunity and a legal challenge to insurers. In effect, a race is now being played out to see which insurer can most competitively and effectively respond to the scope and severity of the Canadian D & O claims environment. Whereas one could probably say that U.S. insurers have honed their domestic D & O programs to a level of comfort and familiarity; the companion Canadian D & O programs are only just now moving off of the drafting tables and in to the marketing arena for the test of real claims coverage. In this context, the process of putting together effective Canadian programs has to be seen as both an anxious and exciting time for D & O underwriters.

The purpose of this paper is to identify the key issues confronting the U.S.-based D & O insurer that is wanting to address exposures in the Canadian market, and conversely, the Canadian insurer confronting exposures in the U.S. market.[2] The paper's focus is to discuss the substantive differences in D & O law in each jurisdiction; and to elaborate on underwriting experiences to date, in responding to such differences. The discussion is organized under the following topics:

- The current Canadian approach to allocation;
- Statutory regulation of D & O policies;
- Status of the D & O who is an "innocent co-insured";
- Comparative scope of coverage;
- Forum non conveniens and the D&O insurer's use of anti-suit injunctions;
- How corporate reimbursement of D & O's in Canada differs from the U.S.;
- The growth of employment practices liability insurance in Canada.

---

[1] According to a Wyatt Company survey, suits against D & O's in Canada are were 50% in the years 1994-1996, and up an annual global rate of 10% overall. Legal costs average in the United States approximately $420,000 (U.S.) and indemnity costs (in excess of deductibles) approximately $4,600,000 (U.S.) (Sources: Binks RiskNotes, 1997; and Robert W. Edwards, "Directors' and Officers' Liability - A Global Overview", *Legal Focus*, July 1996 issue).

[2] Due to the North American Free Trade Agreement, Canadian companies are increasingly looking to the U.S. for investors. There is also an increased flow of goods, services and people between the two countries. The result of this activity is impressive: according to a Wyatt Company survey, 24% of D & O claims against Canadian companies arise out of their involvement with the U.S.A.. (Source: Binks RiskNotes, 1997).

The goal of the paper is to familiarize American D & O insurance underwriters with some of the unique Canadian D & O exposures, and to suggest underwriting methods and litigation strategies by which these unique exposures can be managed.

II. THE CURRENT CANADIAN APPROACH TO ALLOCATION

A key issue confronting D & O insurers in recent years has been the allocation of defence costs and settlement amounts between insured and uninsured party defendants. The issue has been particularly prominent in the D & O context, due to the fact that under a standard D & O policy the liability of the corporate entity is not insured. Standard coverage under a D & O policy is limited to "corporate reimbursement", and is usually delineated by one or both of two standard insuring agreements:

1. The first insuring clause indemnifies the corporation, to the extent that the corporation must indemnify its own directors and officers for their own individual liability, either for damages or other relief, or for the costs of defending, or both.

2. The second insuring clause indemnifies the D & O's *directly* if the corporation is unable to do so.

As underwriters in this field well know, neither of these insuring agreements responds to the corporation's own liability. All of the insurance money flows through to the D & O's.

Thus, when *both* the insured D & O's and the uninsured corporate entity are sued, the issue will often arise as to how the bill for defence costs and settlement amounts will be allocated, as between the insured D & O's, and the uninsured corporate entity. Can the insurer limit its liability to just the proportionate liability of the insured D & O's? How would proportionate liability be determined, in any event? The issue can be particularly difficult to sort out when one defence counsel is retained to represent both the insured and the uninsured interests.

As American underwriters will be aware, the issue of allocation has been the subject of vigorous litigation in the United States, since approximately 1986. Out of that litigation there have emerged several approaches for resolving allocation problems. In contrast to the U.S. experience, however, the issue is a relatively novel problem to Canadian courts, and hence, the issue as to which approach will be adopted in Canadian jurisdictions is only now being litigated. Allocation remains, to some degree at least, an open question in Canada. The purpose of this section of the paper is to discuss the Canadian position.

The American approach, from 1986 until 1995, accepted that any allocation exercise between insured and uninsured parties, must have regard to each party's "relative exposure", "relative benefit" and the "factors considered applicable in the circumstances".[3]

A commonly cited text authority for the factors to be considered applicable is Knepper & Bailey's (5th ed.) popular text on the subject.[4] The factors identified there are:

> *the identity, as an individual, an entity, or as a member of a group, of each beneficiary and the likelihood of an adverse judgment against each in the underlying action;*
>
> (a) the risks and hazards to which each beneficiary of the settlement was exposed;
> (b) the ability of each beneficiary to respond to an adverse judgment;
> (c) the burden of the litigation on each beneficiary;
> (d) the "deep pocket" factor and its potential effect on the liability of each beneficiary;
> (e) the funding of the defense activity in the litigation and the burden of such funding;
> (f) the motivation and intentions of those who negotiated settlement, as shown by their statements, the settlement documents and any other relevant evidence;
> (g) the benefits sought to be accomplished and accomplished by the settlement as to each beneficiary, as shown by the statements of the negotiators, the settlement documents and any other relevant evidence;
> (h) the source of the funds that paid the settlement seem; and
> (i) the extent to which any individual defendants are exempted from liability by state statute or corporate charter provisions; and
> (j) such other similar matters as are peculiar to the particular litigation and settlement.[5]

In 1995, considerations integral to "relative exposure" and "relative benefit" were, however, eliminated in several U.S. jurisdictions as a result of three successive appellate

---

[3] *PepsiCo., Inc. v. Continental Casualty Co.*, 640 F Supp 656 (S.D.N.Y.) 1986; *Nodaway Valley Bank v. Continental Casualty Co.*, 715 F Supp 1458 (WD Mo. 1989), aff'd 916 F 2d 1362 (1990); *Reliance Group Holdings Inc. v. National Fire Insurance Co.*, 594 F Supp 1143 (1993); *First Fidelity Bancorporation v. National Union Fire Insurance Co.*, 1994 W.L. 11136 (E.D. Pa.).
[4] Knepper, William E. & Bailey, Dan A., *Liability of Corporate Officers and Directors*, 5th Edition (Volume 2) (Charlottesville, Virginia: Michie Law Publishers, 1993).
[5] *Ibid.*, at pp. 264-265.

level decisions ("the trilogy"), which adopted what is referred to as the "larger settlement rule",[6] a rule espousing the principle that there should be *no* allocation away from an insured party unless, due to the liability of the uninsured party, the settlement amount was made larger. In the result, the trilogy has made it difficult for an insurer in the United States to achieve any significant "allocation away" of costs or settlement amounts.

The issue of allocation has just recently been before the courts in the Province of British Columbia, in the case of *Coronation Insurance v. Clearly Canadian Beverage Corporation et al.*[7]

The issue in *Clearly Canadian* involved the question of allocation of a settlement, as between the insured D & O's and the uninsured corporation, the B.C.-based company, Clearly Canadian. The underlying action, which had been litigated in the State of California, consisted of a securities action brought against the company and its D & O's. Both the D & O's and the uninsured company had been represented in the suit by the same defence counsel. (Typically, the policy had no "duty to defend" provision.) While the D & O policy stipulated that defence and investigation costs were to be allocated on the basis of the "principle benefit" rule, the policy was silent with respect to allocation of settlement amounts.

A settlement was entered into, following approval of the amount by the D & O insurer on a "non-waiver" basis. The D & O insurer then advanced some funds on account of the settlement, but raised the issue of allocation, arguing that some amount ought to be allocated away from the D & O insurer to the uninsured corporate entity, particularly since there was evidence that the company had had its own distinct reasons, unrelated to the company's liability in the action or any conduct of the D & O's, for wanting to have the litigation settled. The insurer argued that by approving the settlement on a "non-waiver" of rights basis, it had retained the right to contest the proper amount to be funded in view of any subsequent allocation exercise.

The parties were unable to agree on the allocation issue and the insurer commenced a Petition in the British Columbia Supreme Court to have the matter adjudicated.

---

[6] *Nordstrom Inc. v. Chubb & Son, Inc.*, 54 F 3d 1424 (1995, 9th Cir.); *Caterpillar Inc. v. Great American Insurance Co.*, 62 F 3d 955 (1995, 7th Cir.); *Safeway Stores Inc. National Fire Insurance*, 64 F 3d 1282 (1995, 9th Cir.).

[7] Court of Appeal reasons: *Coronation Insurance v. Clearly Canadian Beverage Corporation et al* (January 14, 1999), Vancouver, CA023255 (B.C.C.A.) Trial reasons: *Coronation Insurance v. Clearly Canadian Beverage Corporation et al.* (1997), 33 B.C.L.R. (3d) 129 (S.C.).

Following the initial hearing, the B.C. Supreme Court observed that the issue of allocation has not before been litigated in a D & O context in Canada. The court further noted that, while there had been American consideration of the issue, no single approach to allocation could be said to "govern" the U.S. cases, only whatever approach was "equitable in the circumstances". The court noted that certain approaches seemed to be more relevant to the allocation of settlement payments than to the allocation of defence costs.

The court specifically observed that the problem of allocation arose on the facts of the case, due to the fact that the liability of the D & O's and the corporation might not be concurrent in all cases. In describing the underlying action in California (which alleged violations of the United States *Securities and Exchange Act of 1934*) and its impact on the insurance question, the court stated,

> The legislation creates liability for persons as well as for corporations that violate its provisions. It creates direct liability for corporations, meaning a corporation can become independently liability [sic] for the activities of its directors, officers, and others who conduct its business; it does not derive liability only from their liability. Those who are responsible for a corporation's liability may be able to raise defences that are not available to the corporation based on considerations like the extent of their personal involvement in the wrongdoing, their lack of intent to deceive, and the limited control they exercised over others who bear primary responsibility for the violations. What is important here is that the liability of a corporation and that of its directors and officers whose conduct is the subject of a claim will not necessarily always be concurrent.[8]

The court therefore agreed with the insurer that the potential existed for liability of the corporation without the liability of the D & O's, and further, that there could be liability to the corporation as a result of conduct of persons not insured.

In approaching one of the threshold issues underlying the argument for allocation, the court adopted a common sense approach. The court held that the duty to allocate a settlement amount was not something that was contingent upon there being a contractual provision between the parties. In response to an argument put forth by the company that requiring allocation would be tantamount to 'implying into the contract a provision reducing coverage', the court stated:

> The contention that allocation would require implying a term in the policy is also, in my view, not well founded. The requirement to allocate settlement amounts exists, not because of terms whereby insured and insurer may agree to

[8] *Ibid.*

> it, but because it is essential to limiting the insured's obligations to indemnify to the coverage the policy provides: *Nordstrom* (p. 6) and *Caterpillar* (p. 8). Allocation is an equitable necessity. It does not rest on a contractual agreement *per se*.
>
> The parties to a contract of insurance may stipulate for an early allocation and provide for the way certain expenses will be borne - what are insured - as they have done in this policy with respect to defence costs, and they may covenant to use their best efforts to allocate expenses between insured and uninsured interests: *Safeway* p. 18, but I do not consider the absence of terms of that kind can possibly mean that there can be no allocation once the insurer's consent to a settlement is given as the directors and officers contend.
>
> Allocation between what is insured and what is not has long been a part of insurance. I do not consider any term need be implied in [the insurer's] policy to permit the allocation of settlement amounts even though there is a clause that provides for the early allocation of defence costs.[9]

Ultimately, however, in deciding on the specific approach to be taken in the case, the court adopted the "larger settlement" rule, as set out in the trilogy, and modified by the *Caterpillar* decision, *supra.* The court concluded on the allocation issue:

> I conclude there could be an allocation of the settlement amount in this case, but only to the extent it can be said that the liability that may have been established against the corporation would not have been entirely concurrent with any liability that may have been established against the directors and officers. That, it seems to me, is what the coverage afforded requires and what would be entirely fair and equitable. I consider the allocation for which the insurer contends could well deprive Clearly Canadian of some of the insurance it purchased and lead to a result that would be manifestly unfair.

The court did not agree that simply because the policy specified that defence costs would be allocated according to the "principle benefit" rule, that settlement amounts ought to be allocated upon the same principle. The court also did not agree that considerations underlying adoption of the settlement ought to be considered as a factor in determining the allocation issue. The court relied on the following statement of the court in *Caterpillar*:

> We also believe that a protracted pursuit of the motivations underlying a settlement... is not necessarily the best way to resolve coverage disputes: The question at issue is whether the insurance policy covered certain claims, not the

[9] *Ibid.*, p. 138.

> metaphysical underpinnings of why a corporation or its directors and officers may have acted as they did.[10]

And from *Nordstrom*:

> We reject [the insurer's] contention that allocation in this case should also depend on an analysis of factors other than liability, such as negative publicity, that might have had a practical effect on the amount of the settlement. Although such factors have been applied by other courts, we decline to require consideration of such factors, which likely would lead to protracted discovery on issues wholly outside the context of liability[11]...

At the first instance, the court did not address what sort of allocation ought to result, where *neither* the corporation nor the D & O's had any potential liability.

The insurer appealed to the B.C. Court of Appeal, hoping to persuade the higher court to adopt the principle benefit rule; however, in Reasons released in January, 1999, the Court of Appeal affirmed the trial court's decision.

The appeal judgment sends a strong message to insurers that allocation of settlement amounts will only be granted on the basis of the "larger settlement" rule, *unless otherwise specifically provided for in the contract*. The Court of Appeal rejected all other "equitable" arguments for allocation, and even went so far as to say there was no cause of actions for allocation, beyond an action based on principles of contract.

The court reviewed the insurance contract in question and concluded that the contract's silence on the issue of allocation of settlement funding supported no more and no less than an argument for "full insurance coverage, " i.e. the insurer to cover all settlements of covered liabilities, except insofar as such settlements were made larger as a result of liabilities not covered by the insurance contract which are caused by the presence of non-insured defendants. The court found that the "larger settlement" rule was consistent with the B.C. Court of Appeal's holding in *Continental Insurance Co. v. Dia Met Minerals Ltd.*,[12] finding that "... at least where the insurer does not have conduct of the defence, costs incurred to defend a covered claim are properly segregated from those incurred in respect of a non-covered claim." In the result, the court remitted the matter to the trial court for a determination of "...the extent, if any, to which the settlement of the underlying action was increased by the joinder of CCB as a defendant."

---

[10] *Caterpillar, supra.* note 6, at p. 8.
[11] *Nordstrom, supra.,* note 6, at p. 8.
[12] *Continental Insurance Co. v. Dia Met Minerals Ltd.* (1996), 20 B.C.L.R. (3d) 331 (B.C.C.A.).

The Court of Appeal agreed that the allocation issue remained open, given that the insurer had only agreed to the settlement on a "non-waiver" basis, thereby retaining its right to argue the allocation issue.

With respect to the insurer's arguments that the "principle benefit" rule ought to apply, the court commented that the insurer's argument could be encapsulated into two themes: 1) the theme of "unfairness", i.e. that it would be unfair to allow the uninsured entity to effectively have a "free ride" on the insurance of the D & O's; and 2) the theme of "reasonable expectations", i.e. that the parties to the contract should be taken to have expected the settlement funds would be allocated according to the Knepper & Bailey factors.

With respect to the theme of "unfairness", the Court found that it was neither objectively "fair" nor "unfair" that the uninsured company might benefit from the D & O's coverage, if such benefit were simply a side-effect of the D & O's having the full benefit of the coverage which the court found they had bargained for. The Court concluded that the very existence of the policy itself provided the "juridical reason" for the benefit which had resulted. At the forefront of the Court's reasoning was a consciousness that the uninsured company was in fact an "insured" in other circumstances, and the Court resiled from the insurer, in the court's words, "attempting to obtain restitution from an *insured* (CCB), in order to pay less than full indemnity under one policy of insurance." The Court denied that the right of contribution existing at common law *between insurers*, arising from the common law rule that as a general rule of indemnity an insured may not recover more than his loss, was an appropriate comparator or rationale for justifying the allocation or reimbursement sought by the insurer *from the uninsured company* on the facts at hand.

With respect to the theme of "reasonable expectations", the Court also found that there was no foundation for such an argument, where the policy was silent on the issue of allocation of settlement amounts, and otherwise was worded to cover "all Loss" without qualification or contemplation of the "principle benefit" rule, factors underlying the settlement, considerations of "direct" or "derivative" liability,[13] or otherwise. Consistent with general insurance principles of *contra proferentem*, the court adopted a liberal construction for coverage and a strict construction on limits to coverage. The clear message to insurers was, if you want to allocate a settlement, say so clearly in your policy!

---

[13] "Direct" and "derivative" liability were discussed in *New Zealand Forest Products*, below, and argued by the insurer in *Clearly Canadian*.

To conclude then: the Court of Appeal affirmed that aside from any contractual provisions stipulating for allocation of a settlement liability, allocation may be available, but only to the extent that the settlement can be broken into covered and non-covered claims. Where the settlement is larger due to non-covered liabilities (resulting from the addition of uninsured parties), allocation is appropriate on the grounds that an insurer is only bound to provide such coverage as is set out in the contract.

It is interesting to note by way of comparison, that the New Zealand courts have also recently been grappling with allocation issues. Just last year, a case was appealed to the Judicial Committee of the Privy Council, *New Zealand Forest Products v. New Zealand Insurance Co. Ltd.*[14] The case considered a dispute over the allocation of defence costs.

The New Zealand Court of Appeal had earlier approved the more traditional approach to allocation, i.e. the approach referencing "relative benefit", "relative exposure" and "factors considered applicable in the circumstances", and had even approved the factors identified in Knepper & Bailey (5th ed.), listed *supra.* In the result, the Court of Appeal found that the insurer was only responsible to pay its "proportionate share" of the defence costs.

On appeal, the House of Lords ruled that a proper determination of the issue had to be focused on a proper construction of the policy, rather than on applying general principles of allocation:

> Their Lordships are not persuaded that the guidance given in relation to the one class of case is necessarily applicable to the other. Furthermore there seems to Their Lordships to be a possible danger in concentrating on the case law in that the problem might seem to be one of applying principles of general application rather than construing the language of the particular policy. In that connection phrases such as "the larger settlement rule" and "the reasonably related rule" require to be used with care[15].

The Judicial Committee of the Privy Council specifically ruled that the factors outlined in Knepper & Bailey were *not* relevant to the issue of allocation of defence costs, but the court suggested that they could be valid considerations in the context of allocation of *settlement amounts*.[16] The latter point was argued on the appeal in *Clearly Canadian*.

---

[14] *New Zealand Forest Products v. New Zealand Insurance Co. Ltd.*, [1997] 3 N.Z.L.R. 1 (H.L), on appeal from *New Zealand Forest Products v. New Zealand Insurance Co. Ltd.*, [1996] 2 N.Z.L.R. 20 (C.A.).
[15] At p. 6.
[16] "...as counsel for the appellant pointed out, the costs which the officer is legally obliged to pay on account of the claim against him cannot be measured by factors designed to assess relative exposure to liability in the litigation. The factors may however be helpful and relevant in problems of assessing an

The relevant insuring agreement in the New Zealand policy provided coverage for "...all Loss...which such Officer has become legally obligated to pay on account of any claim(s) made against him...for a Wrongful Act." "Loss" was defined to include "the total amount of the Defence Costs".

The Committee noted that there was no dispute that the costs relating wholly and exclusively to the defence of the insured defendant would be covered. Similarly there was no dispute that costs related wholly and exclusively to defence of non-insured defendants would not be covered. The real issue was over "those costs which relate both to his defence and to the defence of some other defendant or defendants."[17]

In the result, the Committee held that a proper construction of the policy allowed to be covered any cost "reasonably related" to the officer concerned. It held further that "reasonable relation" was a question of fact.[18] The court noted that the "reasonably related rule" seemed to provide "a good shorthand way of indicating that all costs related to the officer are to be covered by the policy whether or not they are costs which also relate to another defendant whose costs are not covered, even though that other defendant may thereby be benefited."[19]

While a detailed discussion of the issue does not lend itself easily to the confines of a paper such as this, it is interesting to consider the argument that in D & O allocation disputes such as these, the bulk of the liability burden is not truly concurrent, since the bulk of the liability can be said to be the "direct" liability of the corporation, and not just "derivative" to the liability of the D & O's. On this interpretation, "direct" liability can be seen as that liability that is created when the conduct of the D & O's is deemed to be the act of the corporation (such as in the case of U.S. securities legislation). In such cases, it is arguably significant that the corporation would bear liability even if the D & O's were not named as parties to the lawsuit. (And notably, conduct and liability of the corporation ("direct" liability) is not insured under a standard D & O policy.) In

---

allocation of settlement sums. Moreover if the problem was one of finding a fair allocation of a total bill of costs as between various defendants then a variety of factors including some or all of those suggested might reasonably be brought into the exercise." (pp. 8-9).

[17] pp. 4-5.

[18] At p. 9.

[19] At p. 7 the court quoted from Judge Rodowsky in *Continental Casualty Co. v. Board of Education of Charles County,* 489 A 2d 536 d 1985), at p. 545:

> "Having purchased this form of litigation insurance, the board is entitled to the full benefit of its bargain. So long as an item of service or expense is reasonably related to the defense of a covered claim, it may be apportioned wholly to the covered claim."

contrast, "derivative" liability is that resulting to the corporation only as a result of operation of law, *e.g.*, *respondeat superior*.

One could make out an argument that in the case of "direct" liability, there should be apportionment, much like in a joint tortfeasor case.[20] The logic of this approach is evident if one considers the converse result: if on the other hand the D & O's were to be held liable for the full burden of such "direct" liability, and if corporation had its own insurer, then the D & O insurer would bear the burden rather than the corporation's own liability insurer - even if the cause of action could have survived without the D & O's being sued! An anomalous result indeed.

Given that in the United States (as a result of the trilogy) the prevailing rule (absent clear language in the policy) has become that a D & O insurer will pay 100 % of the burden of any settlement unless (a) the settlement is paid in part on behalf of uninsured parties for whose acts the corporation is responsible, or, (b) the settlement was made larger by reason of claims which the corporation alone could be held liable, many insurers are inserting provisions into their policies to gain better control over allocation and to avoid the effect of the trilogy.

There is, however, a difference in approach, depending upon whether the insured is a "for profit" or "not-for-profit" entity.

In the case of "for profit" corporations, particularly public companies, traditionally these companies have not been able to obtain entity coverage. Insurers are only now, in response to the trilogy, offering entity coverage, and for securities claims only. Such coverage was originally extended by means of an endorsement; however, since 1996, it has been offered by many D & O insurers as part of their standard policy. Thus, in such cases, with both the D & O's and the entity being covered, no issue of allocation arises in relation to securities claims.

In relation to non-securities claims, however, policies are being re-worded to stipulate allocation guidelines. For example, in its 5/95 form for D & O insurance, American Home has provided:

> With respect to (i) Defense Costs jointly incurred by (ii) any joint settlement made by, and/or (iii) any adjudicated judgment of joint and several liability against the Company and any Director or Officer, in connection with any Claim

---

[20] This approach was discussed at the Court of Appeal in the *New Zealand Forest Products Ltd. v. New Zealand Insurance Co. Ltd.* decision, [1996] 2 N.Z.L.R. 20 (C.A.) at p. 30-37, and was relied on by the appellant insurer in the *Clearly Canadian* appeal.

> other than a Securities Claim, the Company and the Director(s) and/or Officer(s) and the insurer agree to use their best efforts to determine a fair and proper allocation of the amounts as between the Company and the Director(s) or Officer(s) and the insurer, **taking into account the relative legal and financial exposures of and the relative benefits obtained by the Directors and Officers and the Company**. In the event that a determination as to the amount of the Defense Costs to be advanced under the policy cannot be agreed to, then the insurer shall advance such Defense Costs which the insurer states to be fair and proper until a different amount shall be agreed upon or determined pursuant to the provisions of this policy and applicable law. [emphasis added]

Such a provision should be clear enough to preclude any serious dispute over allocation.

In the case of "not-for-profit" corporations and organizations in Canada, the approach has in many ways been simpler. Many Canadian insurers have traditionally included entity coverage in their standard D & O cover for non-profit companies and organizations, perhaps recognizing that the non-profit corporation or organization may only act through its directors, and recognizing that most D & O's do not receive any remuneration or compensation for serving as directors of a non-profit. Such coverage effectively shuts the door on allocation disputes.

III. STATUTORY REGULATION OF D & O POLICIES

While there are many Canadian statutes that affect the *particular exposure* of D & O's and their need for specific coverage (this matter is discussed in the Section D, "Comparative Scope of Coverage", below), it is critical for underwriters of Canadian D & O policies to understand the sources for the regulation and interpretation of D & O policies more generally.

It turns out that due to the fact that the provincial "uniform" *Insurance Acts*[21] regulate by classification of policy type, and D & O policies do not fit into any of the types listed in the statute, D & O policies are (with some exceptions) largely regulated by the common law. For example, B.C.'s *Insurance Act*, which is based on the Anglo-Canadian provincial "uniform" *Insurance Act,* is divided into eight Parts:

Part 1 - Definitions, Interpretation and Application of Act;
Part 2 - General Provisions
Part 3 - Life Insurance

[21] Found in all Canadian provinces except Quebec.

Part 4 - Accident and Sickness Insurance
Part 5 - Fire Insurance
Part 6 - Automobile Insurance
Part 7 - Miscellaneous Classes of Insurance
Part 8 - Administration

While the *Insurance Act* is stated to apply "*...to every insurer that carries on any business of insurance in British Columbia and to every contract of insurance made or deemed to be made in British Columbia*",[22] none of these Parts, except the general governing provisions (Parts 1 and 2), apply to D & O policies. Therefore, subject to that exception, D & O policies in Canada are regulated according to common law principles.

Some of the notable general governing provisions that apply to D & O policies are:

(a) a provision deeming certain contracts to be made in the province (which may impact upon the determination of the proper law of the contract);[23]
(b) all terms and conditions of the policy must be set out in the policy or document in writing attached to it;[24]
(c) provisions for relief against forfeiture;[25]
(d) provisions regulating waiver of a term or condition;[26]
(e) provisions concerning the limitation of legal actions;[27]
(f) provisions regulating the furnishing of the application for insurance and policy wording;[28] and
(g) provisions regarding the liability of a continuing insurer.[29]

These provisions leave a great deal of latitude to the common law for the regulation of many issues. The cumbersome result is that for U.S. insurers wanting to learn about the

---

22 Section 2.
23 *Insurance Act*, R.S.B.C. 1996, c. 226, section 7. For authority that this is an important factor in determining the proper law of the contract to be applied, see e.g. *Cansulex Ltd. v. Reed Stenhouse Ltd.* (1986), 70 B.C.L.R. 273 at p. 288.
24 *Insurance Act*, R.S.B.C. 1996, c. 226, section 12. See also section 8, which sets out the minimum requirements for the contents of an insurance policy: name of the insurer and insured, name of beneficiary, the amount of premium or formula for determining same, the subject matter of the insurance, the indemnity for which the insurer may become liable, the triggering events, effective date and termination date and/or formula for determining same.
25 *Insurance Act*, R.S.B.C. 1996 c. 226, section 10.
26 *Ibid.*, section 11.
27 *Ibid.*, section 22.
28 *Ibid.*, section 25.
29 *Ibid.*, section 27.

applicable law on a given issue, finding answers is not as simple as referring to a statute for guidance. While comparable provisions in the *Insurance Act*(*s*) may provide some insight into how the common law is *likely* to treat these issues (given that the statutes often "codify" certain of the common law tests), nonetheless, for definitive answers, must be found in the case law.

One example of a common law test which has developed is the test for material disclosure by an insured. This issue is obviously a matter of critical importance to insurance underwriters, who depend on proper disclosure in making their underwriting decisions. For determining a non-disclosure problem, the common law test consists of determining whether the insured, at the application stage and during the policy period, made disclosure of all of the facts that a "reasonable D & O insurer" would consider material to the risk.[30] The courts have made clear that a fact is material if it would cause a reasonable insurer to either decline the risk, or stipulate for a higher premium.[31] However, what is reasonable is judged not by what the insurer believes to be reasonable but what the "general community" of D & O insurers would consider to be material to assessing the risk. There is no room for an underwriter with highly subjective or peculiar views as to what is material.

The theory which underlies the test is the notion that the insured knows everything about the risk and the underwriter knows virtually nothing; so, unless the insured makes full and complete and true disclosure, the underwriter cannot properly assess the risk.

At common law, the companion to this obligation being placed on an insured is, if the insured fails to make full and proper material disclosure, and the underwriter determines that there has not been disclosure of a material fact, then (provided the insurer acts quickly upon learning of the material non-disclosure), the insurer has the option to treat the policy as void and return the premium to the insured. In law, the effect is that there was never a policy and therefore the insurer need not respond to any claims.[32]

---

[30] See e.g. *Pan Atlantic v. Pintop Insurance,* [1995] 1 A.C.501.

[31] See e.g. *Kehoe v. British Columbia Insurance Co.*, [1993] 6 W.W.R. 196 (B.C.C.A.).

[32] For example, in Canada, the fact that an insurer has an application containing twenty questions on it does *not* limit an insured's duty to disclose all material facts not covered by the questions. However, if a *specific* question is elicited, then the insured need not volunteer more information in respect of that topic. For example, if an insurer asks "Have you had any claims in the last three years?" an insured is not required to volunteer that he had a claim *four* years ago. In summary, a matter which is material and beyond the scope of the questions must be volunteered if it is material, whereas any additional facts that are within the clear purview of an existing question need not be disclosed.

However, an insurer is prohibited from "deeming" or classifying what is material to a policy. In every case, it is a question of fact for proper judicial authority. For example, the B.C. *Insurance Act* stipulates:

> Misrepresentation and nondisclosure
>
> 13 (1) A contract is not rendered void or voidable by reason of any misrepresentation, or any failure to disclose on the part of an insured in the application or proposal for the insurance or otherwise, unless the misrepresentation or failure to disclose is material to the contract.
> (2) The question of materiality is one of fact.

The exception to this, however, is that if an application for insurance includes a "basis" clause[33] stipulating that the applicant warrants the information given and that it forms the basis for the application, this makes the answers to the questions on the application in the nature of a "true warranty". In such cases, strict compliance with the terms of the warranty is required, and a breach of warranty does not have to be causative to void the policy from the date of the breach. The warranty effectively renders irrelevant whether the answers given are material, or the honesty and care given in answering the questions. If the answers given are untrue, the insurer is at liberty to rescind the policy (subject to its obligation to immediately return the premium).[34]

There are many other common law principles applying to D & O policies in Canada. Under the circumstances, the best advice to underwriters is to seek legal advice as soon as possible on any issue that is not governed by the general statutory provisions.

IV. STATUS OF A D & O WHO IS AN "INNOCENT CO-INSURED"

One of the more interesting issues related to disclosure in the D & O context arises out of the fact that typically in Canada, an application for D & O insurance is signed by only one person and includes a "basis" clause as described above. The policy is stipulated to be based upon the "warranted" representations of the person who signs the application and those representations are deemed to be made on behalf of each D & O so as to bind all of them.

---

[33] *i.e.*, a clause stipulating that true responsive answers given bind and form the basis for the insured's application.

[34] For a discussion of the difference between a "true warranty" and a "suspensive condition" see *The Bamcell II (Century Insurance v. Case Existological Laboratories* (1983), 48 B.C.L.R. 273 (S.C.C.) and *Shearwater Marine Ltd. v. Guardian Insurance Co., of Canada* (1998), 60 B.C.L.R. (3d) 37 (C.A.), affirming (1997), 29 B.C.L.R. (3d) 13 (S.C.).

This raises the issue, "how does a misrepresentation, or material omission, by the signing party affect the other D & O's insured under the policy?" This issue has been hotly contested in American D & O insurance law. Some guidance as to how Canadian courts may be expected to treat this situation in a D & O context can be found in the recent decision of the B.C. Court of Appeal in *McKay v. Cowan*.[35]

The facts of the case involved a claims-made excess professional liability insurance policy issued to some lawyers, following an application made by only one of the lawyer insureds. The applicant lawyer failed to disclose his own ongoing fraudulent activities (dipping into a client's account for a number of years); and when the police caught up with him, the insurer attempted to deny coverage to all of the insureds, even though there was no proof that the "innocent co-insureds" had either participated in, or had knowledge of, the culpable party's fraudulent activities.

The insurer sought to deny coverage on the basis that the policy should be treated as void *ab initio.* The insurer relied to a large extent on the general rule in the law of agency that a principal is liable for the fraud of his agent acting in the scope of his employment and within the scope of his agency.[36] The insurer also emphasized that the application form was in essence the foundation - almost a condition precedent - to the other insured's coverage: had the culpable party not filled out the application, no policy would have been issued at all, whether for the benefit of the culpable party or anyone else.

The innocent insureds, on the other hand, argued strongly that the decision should be guided not by general rules of agency but rather, by the language of the policy, and what a reasonable person would expect regarding coverage, as a result of such language.

The relevant clauses in the policy read:

> VIII. EXCLUSIONS
>
> THIS POLICY DOES NOT APPLY:
>
> (A) To any claim arising out of any act, omission or personal injury committed by the Insured with actual dishonest, fraudulent, criminal or malicious purpose or intent.

---

[35] *McKay v. Cowan (sub nom. Fisher v. Guardian Insurance Co. of Canada) (*1995), 3 B.C.L.R. (3d) 161, 123 D.L.R. (4th) 336 (B.C.C.A.)

[36] One of the authorities relied on by the insurer in this regard was *Lloyd v. Grace, Smith & Co.*, [1912] A.C. 716 (H.L.).

X. CONDITIONS

*****

I. WAIVER OF EXCLUSIONS AND BREACH OF CONDITIONS

Whenever coverage under any provision of this Policy would be excluded, suspended or lost:

(i) because of any dishonest, fraudulent, malicious or criminal act or omission by any Insured, or

(ii) because of non-compliance with any notice condition required solely because of the default or concealment of such default by one or more Insureds responsible for the loss or damages otherwise insured hereunder,

the Insurer agrees that such insurance as would otherwise be afforded under this policy shall continue in effect, cover and be paid with respect to each and every Insured who did not commit or personally participate in, or acquiesce in such activity and who did not remain passive after having personal knowledge of any act, omission or personal injury described in any such exclusion or condition; provided that if the condition be one with which the Insured can comply, the Insured entitled to the benefit of this Waiver of Exclusions and Breach of Conditions upon receiving such knowledge shall comply with such condition promptly after obtaining knowledge of the failure to of any other Insured to comply therewith.

...

L. MISREPRESENTATION

By acceptance of a Certificate hereunder each Insured agrees that the statements made in his application (if any) are true and the coverage provided to him by this policy shall be invalid if he has knowingly given false particulars or intentionally failed to disclose in his application any fact required to be stated.

The court accepted the innocent insureds' argument that this provision was similar to a "severability clause" found in other policies. For example, the court noted that in the case of *Shapiro v. American Home Assurance Co.*,[37] the policy stated:

> Except for the provisions of Condition (b) of this Insurance, this Insurance shall be construed as a separate contract with each Insured so that except as aforesaid,

[37] *Shapiro v. American Home Assurance Co.,* 616 F. Supp. 900 (1984).

> as to each Insured, the reference in this Insurance to the Insured shall be construed as referring only to that particular Insured, and the liability of the Insurer to such Insured shall be independent of its liability to any other Insured.

In the result, the court held that due to the waiver of exclusions clause, the insurer would have to provide coverage for the innocent co-insured and the insurer could not hold the "fraud exclusion" against them, unless the insurer could prove that the innocent co-insureds had themselves acted wrongfully in actual fact. In short, the court concluded that the wrongful conduct could not be imputed on the basis merely that other person applied for coverage.

The court commented:

> Although this case involves a different kind of insurance from that considered in *Panzera*, so far as the rights of multiple insureds are concerned, I am unable to see any real distinction between the two. Here, [the innocent co-insureds] claim the benefit of an insurance policy issued upon the application of [the guilty insured]. In *Panzera*, the mortgagee claimed the benefit of an insurance contract issued upon the application of the property owner. In both cases the insurer contends that the misrepresentation of the applicant should be imputed to the those claiming the benefit of the insurance. In *Panzera*, that argument could not survive an interpretation of the contract language, in light of the reasonable expectations of the parties. Whether it can be sustained in this case ultimately depends on an interpretation of this contract's provisions in the same manner. *Panzera* makes clear that the agency argument is displaced by contractual language and reasonable expectations of the parties to the contrary.[38]

The court suggested that if there was a concern that the culpable party would be unjustly enriched, *e.g.* by a situation of the insurer paying all of the losses even though it was due to the wrongful act of the uninsured culpable party, the insurer could address the problem by inserting a subrogation clause into the policy to allow it to recover against the "breached" insured.

In rejecting the insurer's argument on agency, the court underlined the insurer's failures in preventing what happened:

> Looked at from [the insurer's] perspective, it agreed to issue a "claims made" policy providing coverage for claims falling within the policy definition, not only for the liability of the applicant [who at the time of the application was no longer associated in a firm with the other insureds], but for predecessor firms as well. It

[38] *McKay v. Cowan, supra*, at p. 175. For the *Panzera* case referred to, see note 41, *infra.*

> collected a premium for each of the lawyers named in the application (including [one but not the other of the innocent co-insureds]), and it required the signature of only one person as "owner or partner". It did not require a personal declaration concerning anticipated claims from every lawyer or firm from which insured claims might arise, and it did not contract on the basis that only the applicant was to be insured. In terms of control over the consequences of misrepresentation in the application, [the insurer] was in a better position than either [of the innocent co-insureds]. [The insurer] had the means to protect itself either in the way it chose to issue the coverage, or by the choice of language in the policy.
>
> It seems more realistic, in these circumstances, to resolve disputes over the rights of multiple insureds under the contract on the basis of the language the insurer chose to employ in the policy, than to impute wrongdoing to an innocent insured on the basis of a notional and wholly artificial "agency".
>
> Such an approach is also more in accord with the realities of modern law practice. Modern law firms frequently comprise dozens, sometimes hundreds, of lawyers. Some are partners, some are employees. The members of the firm in both categories change from time to time, as partners and associates leave or retire, new partners are created, and new associates are employed. The only practical means of insuring against liability, in these circumstances, is for one application to be made by a responsible member of the firm, acting on behalf of all the others. If insurers could deny coverage to hundreds of Canadian lawyers insured in this way, because of misrepresentation of the individual who filled out the application on their behalf, the consequences to the public and tot he profession would be enormous, quite unanticipated, and entirely inconsistent with the practical realities faced by the legal profession and the insurance industry.[39]

While the latter comments were obviously directed to the particular context of insuring a law firm, and the insurer's failure to take appropriate precautions to protect its interests under the circumstances, the comments raise an interesting question as to whether a court would be inclined to come to a similar conclusion, or impose a similar burden upon an insurer in circumstances of a corporate D & O setting. It is submitted that while much would depend upon the particular circumstances at issue, it is likely that for a large company with many D & O's, the same result could be anticipated.

It is also important to remember that *absent* the presence of a "Waiver of Exclusions" provision in the policy, an insurer *would be entitled* to raise a properly worded exclusion in defence of a claim by even an innocent co-insured, or for the purposes of voiding the

[39] *Ibid.*, pp. 176-177.

policy on grounds of a material misrepresentation in the application for insurance. Such an exclusion clause should be worded as "*...any claim arising out of any act, omission or conduct committed by* **an** *Insured with actual dishonest, fraudulent, criminal or malicious purpose or intent...*" Notably, if the exclusion were worded as "*the Insured*", an innocent insured could successfully argue that the exclusion only applied to claims made by the particular insured whose conduct was actually in issue.

The approach outlined in *McKay* was adapted from similar approaches in other contexts. In coming to its conclusion, the court drew from prior consideration of the issue of an "innocent co-insured", in the context of fire insurance fraud[40] and in the context of an innocent mortgagee affected by the fraud of a mortgagor in relation to insurance flowing from a standard mortgage clause in a fire insurance policy.[41]

V. COMPARATIVE SCOPE OF COVERAGE

Earlier in this paper, we introduced very briefly the unique statutory and common law framework which applies to the regulation of D & O policies in Canada, from a "regulation of insurance policies" perspective.

However, two more introductions are crucial to rounding out the picture of D & O insurance law in Canada:

1. A brief overview of some statistics on claims patterns in Canada; and

2. A discussion of the different sources (both common law and statutory) for D & O liability in Canada.

Each of these will be discussed in the context of D & O's acting for both "for profit" companies and "non-profit" organizations.

1. Some brief statistics on claims patterns

The following is a brief outline of the source for claims in Canada:[42]

[40] See *e.g.*, *Higgins v. Orion Ins. Co. Ltd.* (1985), 50 O.R. (2d) 352, 17 D.L.R. (4th) 90 (Ont. C.A.).
[41] See *e.g.*, *National Bank of Greece (Canada) v. Katsikonouris*, [1990] 2 S.C.R. 1029 (*Sub nom. Panzera v. Simcoe & Erie Ins. Co.*), 74 D.L.R. (4th) 197 (S.C.C.).
[42] Statistics are taken from the Wyatt Company's 1992 report on directors and officers' liability.

Source	Percent of Total Claims
Customers and suppliers	60 %
Shareholders	3%
Employees	14%

The "severity" of claims is as follows:

• Profit Companies ◊ defence costs 50% of U.S. results ◊ indemnity 15% of U.S. results
• Non Profit Companies ◊ defence costs 10% of U.S. results ◊ indemnity 15% of U.S. results

In terms of the frequency of claims by industry type: (most frequent to less frequent):

Type of Risk	Ratio
Natural resources	0.19
Financial services	0.16
Wholesale and retail	0.12
Insureds with U.S. subsidiaries	0.35
With no U.S. subsidiaries	0.10

Looking at the statistics from a general perspective, it is evident that Canadian society, as a whole, favours the regulatory route, as opposed to civil litigation. Another general explanation for the comparatively low incidence of lawsuits is the fact that in Canada, the loser is responsible to pay the other party's legal costs. Finally, Canadian law affords significant substantive protection to D & Os that act within the scope of their authority, absent any fraud.

2. Sources of liability for D & O's in Canada

(a) Common Law Duties

The leading Canadian decision to outline the duties of a director is *Canadian Aero Service v. O'Malley*.[43] There it is said that a director's duties are the "duties of loyalty, good faith, avoidance of conflict of interest between duty and interest and avoidance of personal profit".[44]

Such duties apply to directors, whether they serve on the board of a "for profit" company or a "non-profit" organization.

The standard of care for a director is generally to meet "the standard or skill of a reasonably prudent person in similar circumstances".[45]

In the case of directors of charities,[46] the standard in Canada may be raised even higher. In certain cases, directors of charities may be held to the standard of a trustee and required to meet that "which a reasonable and prudent person would adopt in the management of that person's own affairs."

While the standard of care for directors of charities has not been finally determined in every Canadian province, applying the standard of trustee seems to be the trend in Ontario.[47] The court's comments in the case of *Re Public Trustee and Toronto Humane*

---

[43] *Canadian Aero Service v. O'Malley* (1973), 40 D.L.R. (3d) 371 (S.C.C.).

[44] As summarized by Anders I. Qurom in "Directors' Legal and Regulatory Responsibilities", a paper presented at the February 7, 1997 B.C. Continuing Legal Education forum on "Charities and Not for Profit Organizations - 1997 Update", at p. 6.1.03.

[45] With the exception of directors of a non-capital corporation in Ontario. There, the objective standard is not specified in the statute, so the common law standard, being the subjective standard of "what a person having the same degree of skill and experience would have done in similar circumstances", would apply. In that regard, see *In Re City Equitable Fire Insurance*, [1925] 1 Ch. 407. Under the subjective standard, the higher the experience of the director, the higher the duty.

[46] Note that the definition of a "charity" varies amongst jurisdictions. "Charitable purpose" most commonly refers to Lord Macnaughten's 1891 definition, which requires a purpose involving (1) the relief of poverty, (2) the advancement of religion, and (3) other purposes beneficial to the community. However, under section 149.1 of the federal *Income Tax Act* a "*registered charity*" is "*an organization, whether or not incorporated, ...all of the resources of which are devoted to charitable activities carried on by the organization itself.*" Registered charities qualify for a tax exemption and donors may obtain a tax deduction in respect of gifts. For a further discussion of this and other related issues, see Douglas R. Johnson, "Directors and Officers' Liability" in Charities and Not-For-Profit Organizations, a program offered by the B.C. Continuing Legal Education Society, February 1996, at p. 7.1.07.

[47] In Ontario see also, *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626, and *Re Harold G. Fox Education Fund* (1989), 69 O.R. (2d) 742. Notably, B.C. does not have a *Charities Accounting Act*, as does Ontario, however, the B.C. *Society Act* at section 32(1) requires a society to "invest its funds only in securities in which trustees are authorized by law to invest." and at section 26 makes reference to the liability of directors for a "breach of trust" [For more discussion of this and other related points, see Johnson, *supra.*, at p. 7.1.11.].

Society,[48] an Ontario case concerning a society recognized as a "charitable organization", highlight the court's overriding concern to protect the interests of the charitable donors to the organization. The court stated:

> The position on the one hand is that the corporation is the trustee of its property, and that since the corporation is without body to be kicked or soul to be damned, its directors must be held to the duties and obligations of trustees. On the other hand is the argument that the corporation is a corporation duly regulated by statute and that, as long as the provisions of the statute are appropriately observed, the obligations of the directors have been met.
>
> ...
>
> Whether one calls them trustee in the pure sense (and it would be a blessing if for a moment one could get away from the problems of terminology), the directors are undoubtedly under a fiduciary obligation to the Society and the Society is dealing with funds solicited or otherwise obtained from the public for charitable purposes...There is no trust document, and I have already indicated that I do not consider the ordinary corporate safeguards to be adequate...I realize that it is common practice for commercial corporations to pay directors, as directors, and often as officers of a corporation, as well. The Society is not a commercial corporation nor is it simply a son-profit corporation; it is a charitable institution.[49]

The court concluded that the society at issue was "*...answerable in certain respects for its activities and the disposition of its property as though it were a trustee...*".[50]

(b) Statutory Sources

As one might expect, there is a long list of "unique-to-Canada" exposures which flow from Canadian federal or provincial statutes affecting and creating D & O responsibilities and liabilities. While it is not possible within the scope of this paper to address each of the general areas of exposure in any lengthy detail, below we identify the significant statutes and areas of concern for insurers to take steps to "Canadianize" their D & O programs. A selection of sample policies is attached as Appendix "A" to the paper.

---

[48] *Re Public Trustee and Toronto Humane Society* (1987), 65 O.R. (2d) 236 (H.C.).

[49] *Ibid.*, at p. 247.

[50] *Ibid.*, at p. 244. (As quoted by Johnson, *supra.*, at pp. 7.1.10).

The Competition Act

The *Competition Act* is federal legislation that was adopted in Canada in 1985.[51] It creates a "level playing field" so that business in Canada remains competitive. The Act is enforced by the Ottawa-based Competition Bureau.

While the Act grants numerous powers to the Competition Bureau to take action against improper conduct, and creates a number of criminal law offences, it also provides for a statutory civil cause of action[52] for damages in favour of a party suffering loss or damage as a result of prohibited conduct or failure to comply with an order of the Tribunal or a court. Both the company and/or its directors and officers may be sued, either together or alone. As in U.S. securities legislation, liability for directors and officers can arise even where the company is not liable. Typical plaintiffs under the Act are customers and competitors.

The kinds of misconduct that can create a D & O exposure under the Act include:

(a) conspiracy or combining to limit facilities, manufacturing of a product, or preventing or lessening competition in the production or supply, etc. of a product or service;
(b) bid-rigging;
(c) conspiracy relating to reducing opportunities for professional sport players;
(d) agreements or arrangements among financial institutions to fix interest rates or charges;
(e) illegal trade practices (including discriminatory pricing, lessening competition or selling at unreasonably low prices to eliminate a competitor);

[51] *Competition Act*, R.S.C. 1985, c. C-34, as amended.
[52] Section 36 provides:

> Recovery of damages
> 36. (1) Any person who has suffered loss or damage as a result of
> (a) conduct that is contrary to any provision of Part VI, or
> (b) the failure of any person to comply with an order of the Tribunal or another court under this Act,
> may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.

(f) exclusive dealing, tied selling and market restrictions;
(g) misleading advertising;
(h) publishing scientific data that is not sufficiently proven;
(i) double ticketing retail products;
(j) pyramid selling;
(k) bait and switch selling;
(l) abuse of dominant market position;
(m) price fixing and maintenance; and
(n) not selling at an advertised price.

Claims under the *Competition Act* are increasing in Canada more rapidly than securities claims. Without a special endorsement, certain of the claims would potentially not be covered under a typical D & O policy. While those claims which resemble a regular negligence suit would likely be covered, certain types of conduct within the purview of the Act would not necessarily be covered, because of the following typical "dishonesty" exclusion found in a standard D & O policy:

> The insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured:
>
> ...arising out of, based upon or attributable to the committing in fact of any criminal or deliberate fraudulent act.

It should be noted that the endorsements which are being written for *Competition Act* claims afford both D & O and entity coverage. This obviates the need for any concern over allocation.

Insurers that are explicitly affording *Competition Act* coverage are <u>not</u> covering applications in respect of knowing contempt, such as a failure to testify or a failure to produce records.

Limits of liability remain the same, despite the additional coverage provided for in the endorsement.

"Oppression" and "Unfairly Prejudicial Conduct" Liability

The concept of minority shareholder rights, as provided for in U.S. legislation, is largely unknown to Canadian law. In Canada, however, the federal *Canada Business Corporations Act,* R.S.C. 1985, c. C-44 and the provincial *Business Corporations Acts* (or equivalents) protect minority shareholders in ways not available in the United States. All federal and provincial statutes empower minority shareholders to apply to a court for an order on the ground that the affairs of the company are being conducted, or the powers of the directors are being exercised, in a manner *oppressive* to a shareholder of the company, or *unduly prejudicial* to such applicant shareholder. Such provisions were patterned on English legislation developed following World War II.

Because of the broad and equitable nature of the "oppression" and "unfairly prejudicial" provisions in the legislation, minority shareholders are choosing increasingly to frame their complaints under these statutory provisions. The provisions are worded broadly enough to encompass a variety of complaints which might otherwise be difficult to categorize in any uniform way. Such provisions are particularly being relied upon in respect of complaints of "freezing out" of a minority, and "watering down" of shareholder rights.

The statute provides that as a remedy, the court may:

(a) direct or prohibit any act or cancel or vary any transition or resolution;
(b) regulate the conduct of the company's affairs in future;
(c) provide for the purchase of the shares of any member of he company by another member of the company, or by the company;
(d) in the case of a purchase by the company, reduce the company's capital or otherwise;
(e) appoint receiver or receiver manager;
(f) order that the company be wound up under part 9;
(g) authorize or direct that proceedings be commenced in the name of the company against any party on the terms the court directs;
(h) require the company to compensate an aggrieved person; and
(i) direct the rectification of any record of the company.[53]

Insurers that are providing coverage for this kind of risk are specifying coverage for claims related to:

(a) the improper sale of option shares by D & O's (to raise capital) where shareholders had pre-emptive rights;
(b) compensation for a shareholder that has been locked out from the company;
(c) compensation in respect of watering down of shares by the issuance of new classes of shares; and/or
(d) squeezing out under the *Company Act* provisions.

[53] See the *Company Act,* R.S.B.C. c. 62, section 224 (2).

Some common exclusions include:

(a) non-monetary claims, such as a claim for an injunction.
(b) directors who are also shareholders
(c) claims by an insured (D & O) against the company or the company against an insured (the "insured versus insured" exclusion)

"Statutory" Liability

Other liabilities that D & O's may be exposed to in the Canadian context are "statutory" claims arising from a failure to comply with the provisions of the federal *Income Tax Act*, R.S.C. 1985 (5th Supp.), the *Excise Tax Act*, R.S.C. 1985, c. E-15, provincial sales tax legislation, the *Unemployment Insurance Act*, R.S.C. 1985, c. U-1, the *Canada Pension Plan Act*, R.S.C. 1985, c. 8, the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, the Ontario *Business Corporations Act*, R.S.O. 1990, c. B-16 and counterpart provincial legislation, and section 251.18 of the *Canada Labour Code* (which deals with D & O liability for unpaid wages in respect of employees working in inter-provincial undertakings in the Yukon or Northwest Territories not otherwise regulated by federal or provincial legislation).

Failures under these statutes generally can be summarized as a failure by the directors and officers to ensure that the corporation deduct, withhold or remit:

(a) tax;
(b) unemployment insurance contributions; or
(c) pension plan contributions; or
(d) a failure to pay wages owing to employees.

By imposing personal liability upon directors, the legislation places a significant burden of "due diligence" upon directors.[54]

In general, such statutory liability for wages and taxes applies to directors and officers, whether they are serving in a profit or non-profit context. The only exception that exists

---

[54] In his own defence, a director is entitled to rely in good faith upon

a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or
b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him.

See *e.g*. section 123(4) of the *Canada Business Corporations Act*.

is if the director is serving on the board of a charity. In certain instances which do vary from jurisdiction to jurisdiction, directors may be exempted from personal liability for wages.[55]

The statutes impose a direct statutory joint and several liability upon the directors and officers, more so than as provided in similar U.S. legislation. They also provide a remedial power to the governments to collect damages without recourse to civil litigation. Liability can potentially be significant: for example, in the case of employee wages, under both the Ontario and the federal *Business Corporations Act*, the statutes provide for personal liability in respect of debts owing for a period of six months' wages. Liability for excise taxes also has the potential to be severe: the federal Goods and Services Tax, for example, provides for a 7% levy on goods and services; and most provinces[56] charge a further levy. As a result of the personal exposure, many directors are resigning when a company approaches insolvency, rather than being faced with the exposure.

A related topic is statutory liability under retirement benefits legislation. Claims could be brought against D & O's for breach of responsibilities, obligations or duties imposed upon fiduciaries by the *Canada Pension Benefits Standards Act*, 1985, R.S.C. 1985, c. 32 (2nd Supp.), or the *Ontario Pension Benefits Act*, R.S.O. 1990, c. P.8, the *Canada Labour Code*, R.S.C. 1985, c. L-2, the *Labour Adjustments Benefits Act*, S.C. 1996, c. 23 or any federal or provincial workers compensation or any similar statutory or regulatory law.

Endorsements covering these types of liabilities generally provide coverage only for the D & O's personal liability and *not* entity coverage for the company. Endorsements typically include a subrogation clause, allowing the insurer to subrogate against the company for such payments out to the directors and officers.

When designing a "statutory" liability endorsement, one problem that needs to be addressed adequately is ensuring that the policy does not appear inconsistent in including "taxes" under the standard "losses that are not covered" clause, then

---

[55] See e.g. Reg. 396/95, s. 45 of the *Employment Standards Act*, S.B.C. 1995, c. 38 which exempts directors or officers of a charity who receive out of pocket expenses but no other remuneration from the general liability for two months unpaid wages set out in s. 96 of the Act. See also s. 58.19(5)(c) of the Ontario *Employment Standards Act* which provides an exemption for wage liability where the person is a director or officer of a corporation that is "carried on without the purpose of gain". Due, however, to the varying legislative requirements from province to province, it is impractical to prepare a special endorsement with respect to charities, and wise to simply limit reimbursement wordings to amounts "*actually* assessed" and "*properly due and owing*."

[56] All of the Canadian provinces except Alberta collect provincial sales tax.

stipulating coverage for tax liabilities in the endorsement. As in other cases, policies need to be reviewed carefully for a consistent approach.

"Pollution" Liability

The liability here is federal and provincial statutes which have been enacted in the past decade which provide for personal liability of D & O's by reason of any environmental harm.[57] The statutes at issue are the Canadian *Environmental Protection Act*, the Ontario *Environmental Protection Act*, R.S.O. 1990, c. E-19, the British Columbia *Environmental Management Act*, and other provincial counterpart laws. The statutes feature the development of site registries and mandatory disclosure requirements in respect of environmental harm.

The environmental harm in issue is "the release into the environment of a toxic substance", as those terms are defined, by a person who owns the substance, has charge of it or causes or contributes to its release. The liability is associated with failing to take steps to prevent such release or, if the release cannot be prevented, failing to take such reasonable steps to remedy the dangerous condition or to reduce or mitigate any threat to the environment or to human life or health.

Statutes in some of the jurisdictions provide a statutory cause of action against the directors and officers, whether or not the company is sued.[58]

The D & O insurance coverage which is contemplated addresses *economic* loss only, covering for example, a claim against the D & Os in respect of a drop in share prices due to the announcement of a pollution liability, a claim in respect of loss of goodwill to the company as a result of a problem with government authorities in respect of an environmental hazard, or a claim in respect of a loss in ability to obtain lenders or new investment for the company.

A typical exclusion clause highlights what is not covered:

> This policy does not provide coverage for claims...

---

[57] Similar to the American *CERCLA*.

[58] See e.g. the Ontario *Environmental Protection Act*, section 136 which provides:

> 136 (1) Any person who has suffered loss or damage as a result of conduct that is contrary to any provision in this Act or the regulations may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct an amount equal to the loss or damage proved to have been suffered by the person and an amount to compensate for the costs of any investigation in connection with the matter and of proceedings under this section.

(a) arising out of, based upon or attributable to the committing in fact of any statute, rule, regulation, agreement, or judicial or regulatory order or other final adjudication adverse to the Insured which establishes such a purposeful violation, or impeding, preventing or attempting to impede, any inquiry or examination under the Canadian Environmental Protection Act, R.S.C. 1985, . 16 (4th Supp.), the regulations promulgated thereunder and amendments thereto;

(b) for property damage including, *inter alia*, asbestos or asbestos-containing materials, or acid rain conditions;

(c) for any direction or request to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize Pollutants[59]

Because of the exclusions above, if an insured wants coverage for property damage, bodily injury or clean-up costs, they will require more specialized environmental coverage for such purposes.

Because the legislation is so new, it is difficult to predict at this juncture the frequency and severity of claims.

From an underwriting perspective, some of the key questions to ask are:

(a) whether the applicant has written policies and procedures in place for the handling, transportation, or disposal of hazardous substances or waste, or for raising environmental issues and concerns;
(b) particulars about an "environmental policy", if one exists;
(c) whether there is a corporate officer assigned to overview environmental issues and compliance with environmental regulations;
(d) whether the applicant uses an environmental consultant firm to advise it;
(e) details re: policies and procedures re: public disclosure of environmental incidents and/or hazards;
(f) whether waste haulers that are used are licensed to transport hazardous waste and substances;
(g) whether assets and acquisitions are regularly evaluated for their potential pollution exposure;

[59] Taken from American Home, Canadian Gold Pack Pollution Liability Endorsement.

(h) details re planned corporate acquisitions or mergers;
(i) whether any director or officer has knowledge of any claims or acts, errors, omissions or conduct that may lead to claims under the proposed endorsement.

Dispute Resolution Clauses

While dispute resolution clauses are fairly standard in American D & O policies and commonly refer to prevailing legislation, with few exceptions,[60] there is no legal requirement to submit to alternative dispute resolution (ADR) in Canada. The process is entirely consensual.

From an underwriting standpoint, an appropriate wording that would achieve a comparable routing of disputes to ADR would be:

> In the event of a dispute or difference which may arise under or in connection with this policy, whether arising before or after termination of this policy, either party may elect to have any such dispute or difference submitted to an alternative dispute resolution process ("ADR") as set forth herein.
>
> Either the Insurer or the Insureds may elect the type of ADR discussed below; provided, however, that the Insureds shall have the right to reject the Insurer's choice of ADR at any time prior to its commencement, in which case the Insureds' choice of ADR shall control.
>
> The Insurer and Insureds agree that there shall be two choices of ADR: (1) non-binding mediation in which the Insurer and the Insureds shall try in good faith to settle the dispute by mediation under or in accordance with its then-prevailing Canadian Mediation Rules; or (2) arbitration conducted under and in accordance with the Ontario *Arbitration Act*, 1991, S.O. 1991, c. 17. In either mediation or arbitration, the mediator(s) or arbitrators shall have knowledge of the legal, corporate management, or insurance issues relevant to the matters in dispute. The mediator(s) or arbitrators shall also give due consideration tot he general principles of the law of the state where the Named Entity is incorporated or formed in the construction or interpretation of the provisions of this policy; provided, however, that the terms, conditions, provisions and exclusions of this policy are to be construed in an even-handed fashion in the manner most consistent with the relevant terms, conditions, provisions or exclusions of the policy. In the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties. In the event of mediation, either party

[60] The exceptions we are aware of have been only "pilot project" ADR programs. These have been in the Ontario Court (General Division) and (currently), the B.C. Provincial Court (Small Claims).

> shall have the right to commence a judicial proceeding; provided, however, that no such judicial proceeding shall be commenced until the mediation shall have been terminated and at least 120 days have elapsed from the date of the termination of the mediation. In all events, each party shall share equally the expenses of the ADR.

The "Duty to Defend" Endorsement

While a duty to defend clause is certainly not standard in American D & O coverage, it is more common in Canada. Such a clause grants the insurer the right and duty to defend any claim covered by the policy, even if the allegations are false, groundless, or fraudulent. It also has the advantage of giving the insurer more control over defence costs, which are usually covered.

The insurer's liability and obligations cease upon exhaustion of the limits of liability, so the endorsement cannot be said to broaden coverage.

Subject to the inclusion of entity coverage, allocation of defence costs will remain an issue as between the insured D & O's and the non-insured corporation.

Concepts which may not be transferable: Bre-X *and "fraud on the market" doctrine*

D & O litigation is growing in Canada and lawyers are in many instances looking to the judicial experience in the United States for ideas with which to build arguments for and against liability. The chances are, the issue has been litigated before in the United States, and often, the cases are so voluminous that it is possible to find an authority for just about any proposition!

However, inasmuch as Canadian courts often do follow an American "lead" on an issue, this is not always the case. It is important to remember that concepts that may be taken for granted in the United States may be wholly inapplicable in the Canadian legal context.

One such concept is the "fraud on the market" theory, which has been widely accepted in U.S. securities litigation, since 1988. The theory permits certain assumptions to be made about the securities market, and in effect, reduces the need for claimants in a securities fraud case to prove all of the usual elements of securities fraud.

Specifically, to state a "normal" case of securities fraud in the U.S. under Rule 10b-5, the following elements must be alleged:

A. a misleading statement or omitted statement;
B. materiality of the misstatement;
C. scienter on the part of the person doing the misleading;
D. reliance by the plaintiff on the misstatement or omission;
E. damages suffered by the plaintiff as a result;
F. a causal link between the damages suffered and the material misstatement or omission.

However, where a plaintiff sues relying on the "fraud on the market" theory, the plaintiff need not specifically prove each of the foregoing elements. This because, as explained by Judge Walker in the U.S. proceedings in *Re Clearly Canadian Securities Litigation*:[61]

> ...A securities market fraud case proceeds on the assumption that investors rely on the integrity of the market to establish a fair and correct price for openly traded securities. Hence, there is no need to prove that individual investors relied on any particular information about the prospects of the security's issuer. *Basic Inc. v. Levinson,* 485 U.S. 224, 244-47, 108 S Ct. 978, 990-91, 99 L. Ed. 2d 194 (1988); *In re Seagate Technology II Sec. Litig.*, 843 F. Supp. 1341, 1355 (N.D. Cal. 1994). Moreover, an allegation that the defendants' misstatement distorted the market price of the security itself satisfies three of the elements required to state a claim for fraud (i.e. elements B, E, F). See Jonathan R. Macey, Geoffrey P. Miller, Mark L. Mitchell & Jeffrey N. Netter, *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of Basic v. Levinson,* 77 Va. L. Rev. 1017 (1991). Given the presumption of reliance, when an alleged misstatement or omission occurs (element A) and affects the trading price of the security on the open market, this price effect denotes the materiality of the misinformation put into the market, satisfying element (B). The price effect, it is theorized, also furnishes elements (E) and (F). Because defendants misled the market, the market, according to the theory, was unable correctly to value the security, whose price diverged from its true value, leading plaintiffs to overpay for (or in the rare case undersell) the security, causing plaintiffs' damages. The amount of those damages is simply the amount of the divergence. See *Green v. Occidental Petroleum Corp.*, 541 F 2d 1335, 1341-42 (9th Cir. 1976) (Sneed, J., concurring).

Acceptance by the court of the "fraud on the market" theory therefore effectively obviates the need for a plaintiff to plead every element of a securities fraud. The plea is reduced to two essential elements: (A) and (C) above, together with an allegation that the price of the security responded significantly to the alleged misstatement or omission.

---

[61] 875 F. Supp. 1410 (N.D. Cal. 1995).

This simplification of the elements of the cause of action gives U.S. plaintiffs an advantage, in that whereas the material misstatement or omission and its effect on the price will be obvious to the plaintiff from the outset of pleading, elements such as the particulars (who said (or failed to say) exactly what, and when), may be unknown at the time of pleading.

In Canada, by way of contrast, under certain provincial regulatory securities legislation (which varies from province to province),[62] a statutory civil cause of action for misrepresentation or fraud in relation to a prospectus and/or press release generally requires proof of:

(a) a misrepresentation in a prospectus, circular or notice; and
(b) damages resulting from such misrepresentation.[63]

Potential defendants include: the issuer or seller of the security, the underwriter of the security, every director of the issuer at the time the prospectus or amendment to the prospectus was filed, every person whose consent was filed, and every person who signed the prospectus.[64]

The right of action is for either an action for damages or a right of rescission.

Interestingly, if a misrepresentation in a prospectus or circular is proven, reliance by the purchaser upon such misrepresentation is *deemed*, where the misrepresentation was in the prospectus at the time of purchase. Also, the amount recoverable by a claimant is capped at "*the price at which the securities were offered to the public*", and a defendant is not liable for "*all or any portion of such damages that the defendant proves do not represent the depreciation in value of the security as a result of the misrepresentation*."[65]

There are various defences available to the defendants to show that they had no knowledge of the misrepresentation, or in good faith reasonably relied on expert opinion in making such misrepresentation, without knowledge of the

---

[62]Certain Canadian provinces do not actually specify a statutory civil cause of action for misrepresentation in respect of a security: see *e.g.* New Brunswick; or their legislation actually limits the civil right of action: see e.g. Prince Edward Island's *Securities Act,* Cap. S-3, section 26. Such provinces do, however, delimit certain *offences* which are subject to penalty.

[63] See *e.g.* Ontario *Securities Act,* R.S.O. 1990, c. S.5, Part XXIII Civil Liability (sections 130-138), or B.C. *Securities Act*, R.S.B.C. 1996, c. 418, Part 16 Civil Liability (sections 131-140).

[64] See *e.g.* Ontario *Securities Act*, section 130.

[65] The legislation places a reverse onus on a defendant to prove that damages sustained do not flow from misrepresentation.

misrepresentation, or to say that the plaintiff was aware of the misrepresentation at the time of purchase. Some statutes provide simply that there is no liability where the act or omission was done or omitted to be done in compliance with the Act, or, any requirement, order or direction pursuant to the Act.[66]

In most provinces, there is *no* provision for assuming that the market has priced the stock or security in reliance upon the corporate representations.[67]

Interestingly, section 196 of the Quebec *Securities Act* makes the likelihood of an effect on the market price a *condition* of the offences there listed. Section 196 provides:

> 196. Every person is guilty of an offence who makes a misrepresentation that is likely to affect the value or the market price of a security in any of the following documents:
>
> 1) the different kinds of prospectuses or the offering notice provided for in Title II;
> 2) the information presented in the annual report and incorporated in the simplified prospectus;
> 3) the information in respect of a reporting issuer provided for in paragraph 1 of section 85;
> 4) the information document provided for in section 67;
> 5) the annual, semi-annual or quarterly financial statements provided for in Title III;
> 6) the press release provided for in Title III;
> 7) the circular prepared in connection with a solicitation of proxies in accordance with Title III;
> 8) the take-over bid circular and issuer bid circular provided for in Title IV.

Section 197 of Quebec's *Securities Act* clarifies that making a misrepresentation other than one that affects the price may also be an offence:

> 197. Every person is guilty of an offence who in any manner not specified in section 196 makes misrepresentation
>
> 1) in respect of a transaction in a security;
> 2) in the course of soliciting proxies or sending a circular to security holders;

---

[66] See *e.g.* Manitoba, *The Securities Act*, C.C.S.M., c. S50.
[67] *Ibid*.

3) in the course of a take-over bid, a take-over bid by way of an exchange of securities or an issuer bid;
4) in any document or information filed with the Commission or one of its agents;
5) in any document forwarded or record kept by any person pursuant to this Act.

However, Title VIII, Chapter II of Quebec's *Securities Act* providing for a civil right of civil for damages does *not* limit the right of action in respect of a misrepresentation to only those misrepresentations that "*are likely to affect the price*".

As already discussed *supra*, Canada's federal *Competition Act* also creates a civil cause of action for loss and damages resulting from a breach of that Act's provisions.[68] In each case, the breach and its causal connection to the loss must be established, for the cause of action to succeed.

Such statutory remedies supplement but do not replace any civil remedies available at law. Apart from the statutory causes of action, there are the common law causes of action for negligent and fraudulent misrepresentation, which have a more general purview than the statutory remedies. The common law cause of action for fraud in Canada consists of proving that a representation was:

(a) made knowingly, or
(b) without belief in its truth, or
(c) recklessly, without caring whether it was true or false.[69]

The same test applies to fraudulent omissions. Whether an action is for negligent or fraudulent misrepresentation, detrimental reliance must be proven by the claimant in an action for damages in each case.

In a recent interlocutory decision out of the Ontario Court (General Division) in the high profile intended class action proceeding styled *Carom et al. v. Bre-X Minerals Ltd. et al.*,[70] the court was asked to consider the applicability of the U.S. "fraud on the market" theory to Canada. This ongoing suit involves proceedings by shareholders and others against the D & O's of the famous (and infamous) mining exploration company, Bre-X Minerals Ltd., and against various promoter securities houses and stock analysts employed by the brokerage firms. The stock, which loomed to fame and brought

[68] See section 36 of the Competition Act, set out in note 51, *supra.*
[69] See *Derry v. Peak* (1889), 14 App. Cas. 337.
[70] Unreported decision of Winkler J., Ont. Gen. Div., November 4, 1998.

fortune to many as a result of its rise from meagre $0.50 beginnings to prices of $228, fell in value to nothing, following revelations that the gold samples had been "salted".

In an October, 1998 application to court, the representative plaintiffs sought amendments to add to their Statement of Claim facts relying on the American "fraud on the market" theory. Application of the doctrine to Canada was previously untested in Canadian courts.

The request to make the amendments was refused. Notably, the test for allowing amendments to pleadings is that generally, such amendments are to be granted, unless there is prejudice which cannot be compensated by costs or an adjournment. Furthermore, such an amendment should only be refused where the amendment would result in another proceeding to strike it out as being "plain and obvious" that it discloses no reasonable cause of action. The court's refusal to allow the amendment was therefore a strong refusal by the court to open the door to the doctrine being applied in Canada.

The court's reasons in the Bre-X application provide a good example of the differences in the U.S. and Canadian approach to a securities action, and are worthwhile examining for that reason.

As observed by the court, the Plaintiffs' pleadings in the Bre-X action were replete with common law allegations of negligent misrepresentation and fraudulent misrepresentation (in addition to pleas of statutory liability). As we have noted, in Canadian law, a key component of these common law causes of action is that the Plaintiff must prove "detrimental reliance" on the negligent or fraudulent statement in each case.

After a review of the American doctrine, the court stated, "*Effectively, the fraud on the market theory creates a rebuttable presumption of reliance on certain misrepresentations, thus obviating the need to prove such reliance on an individual basis*."

The plaintiffs proposed to amend the pleadings to say that the market price of the shares represented misrepresentations disseminated by the defendants; and that therefore, the purchase or holding of such shares by the plaintiffs or the defendant promoters constituted proof of reliance on each and every statement made by the defendants. Obviously, if the theory were accepted, it would make proof of reliance on the alleged misrepresentations easier.

In rejecting the motion to amend the pleadings, the court found that it was "plain and obvious" that the proposed amendments would have no chance of survival on a motion to strike. Interestingly, the court rejected completely the plaintiff's submission that the amendments raised "novel issues" never before addressed in a Canadian context. That conclusion flowed from the court's characterization of the issues. The court concluded that the characterization of the doctrine as a "novel" securities doctrine arising for the first time in Canada was wrong, and that what the issue really amounted to was an attempt by the plaintiffs to sidestep the requirements for their causes of action, which requirements were not "untested" but rather, had been very clearly developed by the Supreme Court of Canada.

Integral to the court's conclusion was its observation that the "fraud on the market" theory was developed in a unique context of complaints founded on a breach of a specific statutory provision found in American securities legislation.[71] The court found that the more general common law context (or causes of action) in which the plaintiffs proposed to advance the theory, was not similar, and moreover, was without the limitations which circumscribed the application of the theory in the United States, namely the unavailability of punitive damages and a shortened limitation period. The court found that punitive damages were in fact pleaded in the Bre-X proceedings and the limitation period in Ontario was significantly longer than in the United States.

The court found further that there was no equivalent Canadian legislative context, and observed that attempts to apply the theory to similar "common law" actions in the United States had been almost unanimously rejected, and in fact, *never* accepted at the appellate level. Finally, the court observed that the objectives underlying the statutory provisions upon which the theory was founded had been interpreted by the U.S. courts as providing a cause of action based on fraudulent behaviour. The court noted that in the instant case, the plaintiffs were seeking to rely on the theory, despite the fact that fraud was not an essential element of all of the causes of action as framed.

Finally, the court noted that whereas in the United States an integral component to a class proceeding was the requirement for "predominance of common issues", and the fraud on the market theory was developed almost to cushion that requirement, in Ontario by contrast the *Class Proceedings Act* in Ontario did *not* incorporate a requirement for "predominance of common issues", thus making it much easier to proceed with a class action here. The court noted that the theory had been developed in part to counter attempts by U.S. defendants to defeat certifications in U.S. class actions. In contrast, in Canada, it is much easier to achieve certification in a class action, given

[71] Rule 10b-5 of the Security and Exchange Commission's Rules under section 10(b) of the *Securities Exchange Act of 1934,* Stat. 881, 15 U.S.C. para. 78a.

the wider scope for certification, and specifically, the lack of a requirement for predominance of common issues.[72]

To all of the foregoing concerns, the court concluded:

> The adoption of the fraud on the market theory by an Ontario court cannot be justified where neither the statutory duty, the cause of action founded upon its breach, nor the predominance test as a procedural barrier to class proceedings exist. More so, the plaintiffs seek to apply the theory to common law causes of action, to which it would not be applicable in the United States, and in a wholesale fashion, without the restrictions which circumscribe it there. Simply put, the proposition advanced is ill-conceived.
>
> The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance in either tort. In the context of the torts of fraudulent and negligent misrepresentation a presumption of the nature advocated for by the plaintiffs does not exist in Canadian common law. Indeed, to import such a presumption would amount to a redefinition of the torts themselves.
>
> Alternatively, the plaintiffs contend that the breach of the Competition Act, pleaded in the Bre-X actions, provides a statutory framework similar to the Rule 10b-5 context within which the fraud on the market theory was developed. Therefore, it is said, the theory is applicable to the private right of action granted under s. 36 of the Act. I cannot accede to this submission. In my view, the analogy between the Act and the Rule 10b-5 cause of action is flawed. The *Competition Act* is not specific securities legislation, nor is it restricted to claims based in fraud. Rather it requires a false or misleading representation to the public that is made negligently but need not be made fraudulently. See *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154.
>
> By way of further comparison, as discussed in detail above, the predominance of common issues requirement, which was significant in furthering the acceptance of the fraud in the market theory in the United States is not present here as an obstacle to a class proceeding. I note also that the position of the plaintiffs in argument on the prior pleadings motions, and in their pleadings, has been that

[72] On that finding, the court referred to the decision of the Ontario Divisional Court in *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.).

> reliance is not an essential element of an action under s. 36. The argument relying on the *Competition Act* fails.
>
> It is clear from an examination of the proposed amendments that they are framed specifically with the fraud on the market theory in mind. In light of my conclusions regarding the theory and resultant presumption, the amendments can have no other useful purpose and are irrelevant.
>
> Applying the "plain and obvious" test from Hunter, in the manner suggested by Lax J. in Atlantic Steel, the plaintiffs' motion for leave to amend is dismissed for the reasons stated above.

The *Bre-X* case should provide good fodder for comparison between D & O litigation in the two countries. Not only are there several Canadian suits in progress, but there is also a Texas-based class action currently working its way through the system. It will be interesting to follow the suits to see how the various suits progress.

VI. *FORUM NON CONVENIENS* AND THE INSURER'S USE OF ANTI-SUIT INJUNCTIONS

The *Bre-X* example is a reminder that we live in an international world, companioned by multi-jurisdictional litigation. In this section, we discuss some of the strategies for managing multi-jurisdictional litigation. We will use the 1993 decision of the Supreme Court of Canada in *Amchem Products Inc. v. British Columbia (Workers' Compensation Board)*[73] as our jumping off point for the discussion.

This B.C.-sourced case challenged the propriety of certain actions which had been commenced in Texas by 194 persons who allegedly suffered injury or death as a result of being exposed to asbestos. The key to the B.C. court's involvement was that most of the claimants sustained their injuries while residents of British Columbia; all but forty had been paid compensation by the B.C. Workers' Compensation Board. In all but the latter cases, the W.C.B. had a subrogated interest to the extent of compensation paid out. The defendants consisted of various companies having no connection with British Columbia, and having the United States as their place of incorporation and principal place of business. The claims alleged that the defendants engaged in tortious conduct in the United States: making decisions pertaining to the manufacture of asbestos-containing products, conspiring to suppress knowledge of the dangers of such products, and failing to warn or provide adequate instructions for use in respect of the dangers associated with use and exposure to such products.

[73] *Amchem Products Inc. v. British Columbia (Worker's Compensation Board),* [1993] 1 S.C.R. 897 (S.C.C.).

The relief sought by the defendant companies in British Columbia was an injunction against the Texas claimants preventing them from proceeding with a continuation of the Texas actions. The defendant companies also sought a declaration that British Columbia was the natural forum, a declaration that they were not liable to any of the claimants in respect of the matters raised in the Texas action, a further injunction restraining the Texas plaintiffs from taking any further steps to prevent the defendant companies from seeking the relief sought in the B.C. application, and a further claim for damages for abuse of process.

At the heart of the case was determining on what principles a court should exercise its discretion to grant an anti-suit injunction, and how the principles applied to the facts of the case. By the time the proceeding reached the Supreme Court of Canada, the defendant companies had unsuccessfully applied for a stay of proceedings in the Texas court (the stay was opposed on the grounds that the doctrine of *forum non conveniens* was statutorily abolished in Texas), but had successfully obtained an order for the injunction in the in the B.C. Supreme Court, and such order had been upheld on appeal. However, the claimants in the Texas suit had obtained in the Texas court an "anti-anti-suit injunction" with a limited period of currency, prohibiting the seeking of such injunctions in British Columbia.

In approaching the issue, the Supreme Court of Canada noted that the issue of choice of forum has become more prominent, due to the increasingly international nature of litigation, business and commerce. As a result, a defendant may be identified not just with one forum but with several, and similarly, plaintiffs may reside in different jurisdictions. The court observed, "Frequently, there is no single forum that is clearly the most convenient or appropriate for the trial of the action but rather several which are equally suitable alternatives." Against this, however, it was noted that "forum-shopping" is to be discouraged.

The court observed that the more traditional method for controlling a plaintiff's choice of forum has been through an application for a stay of proceedings, considered under a test of *forum non conveniens*. An application for a stay of proceedings is brought by a defendant in the forum selected by the plaintiff. The court is asked to refuse jurisdiction, on grounds that the case should be tried elsewhere because there is another more convenient and appropriate forum for the trial of the action and the pursuit of justice (the test for *forum non conveniens*).

The court noted that the alternative method is the anti-suit injunction, where a defendant from a foreign court applies to the domestic court for the foreign proceedings to be enjoined. The domestic court in that sense determines the issue of jurisdiction for the foreign court. An injunction order is enforceable *in personam* upon the plaintiff.

The court held that in the Canadian context, it was appropriate to develop a test built on the foundation of the principles outlined in the English anti-suit injunction case of *SNI Aerospatiale v. Lee Kui Jak*.[74]:

(a) as a preliminary matter, an application for an anti-suit injunction should only be entertained where a serious injustice will occur because of the failure of the foreign court to apply the *forum non conveniens* test;

(b) as a preliminary matter, the domestic court should not entertain an application for an injunction if there is no foreign proceeding pending, and if the foreign court stays or dismisses the foreign action, the problem is solved;

(c) the domestic court should only entertain an application for anti-suit injunction if it is alleged to be the most appropriate forum and is potentially an appropriate forum.

The court held that a proper analysis would consist of:

(d) first, determining whether there is another forum that is clearly more appropriate (i.e., applying the *forum non conveniens* test of real and substantial connection with the forum at hand, and whether there is a more appropriate jurisdiction, based on the relevant factors,[75] including whether the claimant will lose any juridical advantage);

(e) as a matter of comity, if the foreign court has generally assumed jurisdiction on a basis in general conformity with the Canadian rule of private international law for determining *forum non conveniens*, the domestic court should respect the foreign court's decision to take jurisdiction and the application should be dismissed;

---

[74] *SNI Aerospatiale v. Lee Kui Jak*, [1987] 3 All E.R. 510 (P.C.).

[75] The court quoted from Lord Goff in the House of Lords decision of *Spiliada Maritime Corp. v. Cansulex Ltd.*, [1987] A.C. 460 (H.L.):

> So it is for connecting factors in this sense that the court must first look; and these will include not only factors affecting convenience or expense (such as availability of witnesses), but also other relevant factors such as the law governing the relevant transaction (as to which see *Credit Chimique v. James Scott Engineering Group Ltd.*, 1982 S.L.T. 131), and the place where the parties respectively reside or carry on business.

(f) if, however, the domestic court concludes that the foreign court assumed jurisdiction in a manner inconsistent with principles relating to *forum non conveniens* (and is therefore itself not respecting rules of comity), the domestic court may go on to consider the next step;

(g) the next step is to consider whether the domestic jurisdiction is the natural forum, and whether the ends of justice require the injunction to be issued, which involves a consideration of:

   (i) whether injustice to the defendant would result from the foreign proceeding being continued;[76]
   (ii) whether injustice to the plaintiff would result from the foreign proceeding not being allowed to continue;
   (iii) generally no injunction will be granted if the plaintiff would be unjustly deprived of personal or juridical advantages in the foreign jurisdiction, if the plaintiff has a reasonable factual connection with the foreign jurisdiction.

Applying the foregoing test to the facts in *Amchem*, the court ruled that there was a sufficient connection with Texas on the evidence, that the jurisdiction in Texas was assumed on a proper basis,[77] and therefore the decision to assume jurisdiction ought to be respected and the application for anti-suit injunction dismissed.

The decision in *Amchem* to permit the issuance of anti-suit injunctions under certain circumstances is consistent with the English practice, which has exercised jurisdiction to restrain proceedings in a foreign court, since 1821,[78] on the grounds that the ends of justice required it. The test in *Amchem* is not, however, necessarily consistent with the practice in the United States. As stated by the court in *Amchem*:

> In American jurisprudence there are no precise rules governing the issuance of anti-suit injunctions; rather, the equitable circumstances are examined to determine whether the injunction is required to prevent an irreparable miscarriage of justice. A court is to be guided by two tenets. Firstly, the

---

[76] The court rejected the requirement that the foreign proceeding be "vexatious and oppressive" which was set out in SNI, in favour of the resulting "injustice" formulation set out herein.
[77] Jurisdiction was assumed according to the Due Process Clause of the 14th Amendment of the U.S. Constitution, which limits jurisdiction on the basis of minimal contact with the defendant and the forum. In this case, it was assumed where some of the parties were resident in the state and carry on business or are not resident and carry on business, and therefore, in a manner consistent with Canada's own rules of private international law.
[78] See *Amchem, supra.*, at pp. 926-27.

> fundamental corollary to concurrent jurisdiction must be respected: parallel proceedings in concurrent in personam actions are allowed to proceed simultaneously. Second, impedance of the foreign jurisdiction is to be avoided. (See *Laker Airways*, *supra.*, at pp. 926-27.)
>
> ....
>
> As observed by Lord Goff in *SNI*, there is no suggestion in American jurisprudence that applications for stays of proceedings and anti-suit injunctions are governed by the same principles.

The court further noted that not all American courts abide by the rule favouring parallel proceedings. The court identified both a conservative and a liberal approach, each having distinct features and criteria for allowing an injunction.[79]

What all of the foregoing means in practical terms for D & O policy management is that it may be possible, in certain circumstances, to obtain an injunction to prevent a lawsuit from proceeding in the United States, if the test for anti-suit injunction is met in Canada. This is significant, because due to international differences in civil procedure and underlying reasons to litigate,[80] it may be more advantageous to an insurer to have the action proceed in Canada rather than in the United States.

For example, in Canada, most lawsuits consist of an action for damages. Unmeritorious suits are discouraged by the means of the following factors:

(a) the pleadings must identify a cause of action supported by allegations of material facts to warrant a demand for documents and the right to conduct examinations for discovery;
(b) an unsuccessful litigant bears costs consequences;
(c) jury trials are not universally available;
(d) punitive damages are only available in a narrow range of cases;
(e) there is a "rough upper limit" on general damages fore bodily injury;[81]
(f) strict liability doctrine is limited to cases of inherently dangerous products; and
(g) there is no anti-trust legislation available for private litigants save limited forms of relief under the *Competition Act.*

---

[79] See *Amchem*, *supra.*, at pp. 926-27 for the court's discussion of this issue.
[80] The comments below are adapted from Eric A. Dolden, "The Contemporary Canadian Application of the Anti-Suit Injunction to Restrain Foreign Legal Proceedings."
[81] *Andrews v. Grand & Toy,* [1978] 2 S.C.R. 229, 83 D.L.R. (3d) 452 (S.C.C.).

In the United States, by contrast, litigation is often not limited to a claim for damages. Many litigants view triple damages and the ready availability of punitive and exemplary damages as instruments by which product safety and competition within business can be properly maintained. The Canadian approach to judicial power is by comparison far more limited in scope.

In addition, the constraints on litigation in the United States are fewer:

(a) the complaint, while needing to allege a cause of action, need not allege material facts upon which the complainant will rely;
(b) the complaint is normally accompanied by requests for depositions and interrogatories which are wider in scope than their Canadian counterparts;
(c) the scope for recovering one's own costs is more limited;
(d) jury trials are generally available as of right;
(e) there are few constraints on the award of punitive damages;
(f) with the exception of those states that have prescribed limits by statute, there is no upper limit on general damages for bodily injury;
(g) strict liability and related doctrines predicated upon an implied warranty are widely invoked; and
(h) the *Clayton Act* (15 USC 15) and the *Sherman Antitrust Act* (15 USC 1-2) permit a private litigant to maintain antitrust actions in a wide range of circumstances which can exceed compensatory loss by a multiple of three.

In the D & O liability context, the general trend seems to be that insureds receive more favourable coverage decisions in the United States than in Canada. Also, as we have already discussed, in the absence of any specific contractual provisions, U.S. courts are now deciding allocation issues according to the "larger settlement" rule, which rule is the least favourable to D & O insurers. Because D & O law in Canada is at a more nascent stage on some issues, it may be advisable for a D & O insurer to adopt a strategy of trying to block a U.S.- based proceeding, in favour of moving it to the more flexible Canadian jurisdiction to argue the issue afresh without the burden of a higher court's disadvantageous but binding precedent on the issue.

A comparable strategy was adopted by the insurer in *Clearly Canadian*. Despite the fact that the underlying proceedings had taken place in California, the insurer initiated the proceedings in respect of insurance coverage and allocation in British Columbia, given that there was a strong connection with British Columbia on the facts of the case, and given that the insurer was faced with a disadvantageous approach to the issue in the

United States. By having the matter heard in Canada, the insurer was placed in a more powerful position vis-à-vis the allocation issue, than it would otherwise have been in, had the matter proceeded in the State of California.

Similarly, for D & O insurers confronting a disadvantageous situation in a U.S. court proceeding, in cases where Canada appears to be the *forum conveniens* and the connection with the United States tenuous, it may be worth considering an anti-suit injunction to oppose the U.S. proceeding.

VII. CORPORATE REIMBURSEMENT: DIFFERENCES BETWEEN CANADA AND THE U.S.

As highlighted in the discussion of allocation, *supra*, D & O corporate reimbursement policies traditionally insure under one, or both, of two separate and distinct coverages. The first insuring clause indemnifies the corporation, to the extent that the corporation must indemnify its own directors and officers for their own individual liability, either for damages or other relief, or for the costs of defending, or both. The second insuring clause indemnifies the D & O's *directly* if the corporation is unable to do so. In either case, the policy only insures the liability of D & O's, not the liability of the corporation.

A common wording for the first insuring clause in respect of corporate reimbursement of D & O's provides that the insurer is to reimburse only for "*...such loss as the company is required by law, or agreed as permitted by law, to indemnify such directors or officers*." Such a wording alludes either to statutory regulation of corporate reimbursement, or alternatively, to "corporate constitutions" setting limits on corporate reimbursement.

An examination of the issue reveals that corporate reimbursement of D & O's is an area fraught with policy concerns. Currently, in North America such policy concerns are evidenced through three different methods:

(a) use of contractual indemnity between the corporation and the D & O's without any constraints being imposed by the incorporating statute of the corporation's domicile;

(b) regulation by means of the corporation's incorporating documents, so that indemnification of D & O's, as permitted by statute, is "permissive" and, as a result, the corporation can, by means of its incorporating documents (typically the Articles of Incorporation) authorize reimbursement either upon approval by the shareholders, or, other "disinterested" directors; and

(c) the necessity of judicial approval without regard to the company's incorporating documents or "internal constitution".

Most U.S. states have adopted the second method for corporate reimbursement, i.e. the states are "permissive" on the matter of corporate reimbursement of their D & O's.[82]

At the federal level in Canada, the *Canada Business Corporations Act* provides (at section 124) that a corporation may, without court approval, reimburse its D & O's against all costs, charges and expenses, including settlement amounts, if

> a) [the director or officer] acted honestly and in good faith with a view to the best interests of the corporation; and
> b) in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, [the director or officer] had grounds for believing that his conduct was lawful.

The foregoing provision is consistent with the statutory duty of care specified at section 122, requiring that a director and officer "*...act honestly and in good faith and with a view to the best interests of the corporation...*" and "*...exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances*".

The only specified exception to reimbursement without court approval is in the case of a derivative action, in which case the corporation must obtain the approval of the court before indemnifying the D & O's.

Section 124 further provides for an indemnity as of right, in the case of a successful defence by a D & O:

> 124(3) Notwithstanding anything in this section, a person referred to in subsection (1) is entitled to indemnity from the corporation in respect of all costs, charges and expenses reasonably incurred by him in connection with the defence of any civil, criminal or administrative action or proceeding to which he is made a party by reason of being or having been a director or officer of the corporation or body corporate, if the person seeking indemnity
>
> > a) was substantially successful on the merits in his defence of the action or proceeding; and
> > b) fulfills the conditions set out in paragraphs 1(a) and (b).

[82] See Knepper, William E. & Bailey, Dan A., *Liability of Corporate Officers and Directors*, at p. 390-392.

The section also stipulates that D&O insurance may be purchased, on the following terms:

> 124(4) A corporation may purchase and maintain insurance for the benefit of any person referred to in subsection (1) against any liability incurred by him
>
> a) in his capacity as a director or officer of the corporation, except where the liability relates to his failure to act honestly and in good faith and in the best interests of the corporation; or
>
> b) in his capacity as a director or officer of another corporate body where he acts or acted in that capacity at the corporation's request, except where the liability relates to his failure to act honestly and in good faith with a view to the best interests of the body corporate.

Furthermore, the court may order that notice be given to interested persons to appear and be heard on any such application for approval of indemnification.[83]

The Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, at section 136, and the Alberta *Business Corporations Act*, R.S.A., c. B-15, at section 119, each have parallel provisions to those found in the federal legislation, with some minor differences in wording.

In the recent case of *Blair v. Consolidated Enfield Corp.*,[84] the Supreme Court of Canada considered the provisions of section 136 of the Ontario *Business Corporations Act*. The case involved a claim for indemnification by the respondent, who was both director and president of the appellant corporation. At issue was some infighting between the director/president and another shareholder, which culminated in an issue arising in respect of the director/president's handling of a proxy vote. The director/president sought indemnification of his legal costs in defending his corporate acts.

Much of the debate turned on the proper construction of section 136. In that regard, the court made the following comments:[85]

> (a) persons are assumed to act in good faith unless proven otherwise (citing *General Motors of Canada Ltd. v. Brunet*, [1977] 2 S.C.R. 537 at p. 548);
>
> (b) a director is not required to prove good faith, but may call evidence to rebut any evidence of bad faith;

---

[83] See section 124(7) *Canada Business Corporations Act.*

[84] *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5.

[85] *Ibid*.

(c) in general, it is the corporation that must establish that what a director did was not in best interests of the corporation;

(d) whether the acts were taken in that person's capacity as a director is critical to founding an entitlement to indemnity;

(e) relying upon the advice of legal counsel demonstrates good faith, where it is reasonable to believe that taking such advice was the only proper course, where there is no reason to doubt the competence of the source of advice, and where it would appear unreasonable to reject the advice.

The court concluded on the policy issue:

> Permitting [the director/president] to be indemnified is consonant with the broad policy goals underlying indemnity provisions; these allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection. Indemnification is geared to encourage responsible behaviour yet still permit enough leeway to attract strong candidates to directorships and consequently foster entrepreneurism. It is for this reason that indemnification should only be denied in cases of *mala fides*. A balance must be maintained... [86]

In British Columbia, unlike the other provinces outlined, *any* reimbursement by a corporation to its directors and officers in respect of legal costs and charges associated with a settlement or liability, must *first* be applied for and judicially approved in accordance with section 128(2) of the *Company Act*.[87] The need for court approval is not limited to reimbursement in respect of costs associated with derivative actions.

Section 128 of the British Columbia *Company Act* provides:

> **INDEMNIFICATION**
>
> 128. (1) A company may, with the approval of the court, indemnify a director or former director of the company or a director or former director of a corporation of which it was a shareholder, and his heirs and personal representatives, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, actually and reasonably incurred by

---

[86] At para. 74.

[87] Provisions akin to section 128 of the *Company Act* were initially adopted in New York in 1941, and were quickly followed in Delaware. Delaware provided the state "model" that ultimately led to the American "Model Business Corporations Act". It was the introduction of the Model *Business Corporations Act* that led to the adoption to the Canadian counterpart legislation, including section 128 of the *Company Act*, R.S.B.C. 1996, c. 62.

him, including an amount paid to settle an action or satisfy a judgment in a civil, criminal or administrative action or proceeding to which he is made a party by reason of being or having been a director, including an action brought by the company or corporation, if

(a) he acted honestly and in good faith with a view to the best interests of the corporation of which he is or was a director; and

(b) in the case of a criminal or administrative action or proceeding he had a reasonable grounds for believing that his conduct was lawful.

(2) The court may, on the application of a company, director or former director, make an order approving an indemnity under this section, and the court may make any further order it considers appropriate.

(3) On an application under subsection (2) the court may order notice to be given to any interested person.

(4) A company may purchase and maintain insurance for the benefit of the person referred to in this section against any liability incurred by him as a director or officer.

(5) Subsections (1) to (3) apply to officers or former officers of a company or of a corporation of which the company is or was a shareholder.

The policy thrust of section 128 and counterpart legislation can be seen as a stringent attempt by the legislature to protect shareholders against conduct by D & O's which is not "honest" or "in good faith with a view to the best interests of the company", and which could otherwise result in legal action, liability, and/or the erosion of the company's assets to the detriment of the shareholders. For example, in the context of a securities case, if it were found that a director or officer had made a misrepresentation in bad faith that was not authorized by the company, the shareholders would have a means to argue that reimbursement ought to be denied to that director or officer in respect of any liability (charges, costs or settlement) related to the misrepresentation.

Section 128 has not received much in the manner of judicial consideration in British Columbia. However, section 136 of the Ontario *Business Corporations Act* has been treated as a comprehensive "code" that regulates when a corporation may or may not indemnify its D & O's.[88]

---

[88] *R. v. Bata*, [1995] O.J. No. 2691 [QL](C.A.), at para. 25.

Notably, those U.S. states that have a statutory mechanism similar to section 128, have consistently held that compliance with the statutory mechanism, including judicial approval, is a condition precedent to the insurer's contractual obligation to undertake "corporate reimbursement" under an insuring agreement requiring the insurer to reimburse the company for amounts paid out by the company which the company "was required by law, or agreed as permitted by law, to indemnify the Directors and Officers."[89]

For example, in *PLM Inc. et al. v. National Union Fire Insurance*,[90] the court made clear that words in a policy under a corporate reimbursement clause which read, "*...is required by law, or agrees as permitted by law...*" obligated the company to comply with the company's "mandatory" incorporating statute requirements. The case was situated in California, where indemnification of D & O's required either (a) approval by a majority vote of disinterested directors, or (b) approval by a majority vote of disinterested shareholders, or (c) Court Order. None of the mandatory steps had been undertaken, and the court concluded that this precluded corporate reimbursement in accordance with the insuring clause. The D & O's argued that they could, nonetheless, recover the amounts under the D & O reimbursement clause. In response, the court held that in circumstances wherein there was no personal outlay by the D & O's, they could not use this argument to thereby gain reimbursement personally in an effort to avoid compliance with the dictates of the incorporating statute.

Similarly, in *Waldboro Bank v. American Casualty Company*,[91] the court concluded that the words "*...permitted by law...*" required that a bank (in its capacity as an insured) comply with the corporate mandates required of that bank in relation to indemnification of its officers. On the facts of the case, the legislation required written notice to be give to a federal bank regulator. The court concluded that non-compliance barred corporate reimbursement under the policy. The D & O's argued that the insuring clause providing for "direct" reimbursement of D & O's permitted them to avoid the statutory notice requirement; however, the court rejected the argument, stating that to permit this to occur would "*...eviscerate the "extent permitted by law"...*" requirement in the corporate reimbursement insuring clause.

Such matters have recently been argued in the Canadian context in the *Clearly Canadian* appeal. The insurer in *Clearly Canadian* argued that the U.S. approach outlined in *PLM*

---

[89] See *e.g. Atlantic Permanent Federal Savings and Loan Association v. American Casualty Company*, 839 F 2d 212 (4th Circuit, 1988) at p. 215; *MacMillan Inc. v. Federal Insurance Company*, 741 F Supp 1079 (S.D.N.Y. 1990) at p. 1083; Knepper, William E. & Bailey, Dan A., *Liability of Corporate Officers and Directors*, at p. 390-392.

[90] *PLM Inc. et al. v. National Union Fire Insurance*, [1986] W.L. 74358 (N.D. Cal.).

[91] *Waldboro Bank v. American Casualty Company*, 775 F. Supp. 432 (D. Maine, 1991).

and *Waldboro* should be adopted; however, to date the matter has not yet been judicially determined.

One exceptional circumstance which D & O insurers need to be cognizant of in the corporate reimbursement context, is non-profit or non-share capital organizations. Depending upon provincial legislation (for example, in British Columbia, under section 30(2) of the *Society Act*), a society is authorized to indemnify a director *without* judicial approval, provided the conduct of the director was made in good faith and was lawful. At the federal level, non-profit organizations incorporated under the *Canada Corporations Act*, R.S.C. 1970, may also indemnify directors. Section 30(4) of the B.C. *Society Act* specifically authorizes the purchasing of insurance.

Thus, to conclude, in the Canadian context, depending upon the kind of action underlying the claim for reimbursement, and depending upon the provincial jurisdiction and whether the company is "for profit" or "not-for-profit", corporate reimbursement of D & O's may require judicial approval first. To that extent, D & O corporate reimbursement coverage in Canada is shaped by statutory regulation.

VIII. THE GROWTH OF EMPLOYMENT PRACTICES LIABILITY INSURANCE IN CANADA

Employment practices liability (EPL) is a growing area of liability for D & O's in Canada.[92] New insurance products addressing this exposure are being added all the time, and the market is becoming quite competitive. Due to some significant differences in employment law in the two jurisdictions, a detailed discussion is appropriate.

What are EPL claims? EPL refers to liability stemming from discrimination in the workplace, sexual harassment and other employment-related practices and conduct that may give rise to legal liability. Such conduct is regulated in Canada at both the federal and the provincial level,[93] and is often placed under the exclusive jurisdiction of

---

[92] The Wyatt Company's survey reports that EPL is the second largest source for claims in North America, Europe and Australia/New Zealand after shareholder actions, and accounts for approximately 25% of claims in these areas. (Source: Edwards, *supra*).
[93] The Canadian *Constitution Act* makes "property and civil rights" a subject of provincial jurisdiction, but, "federal works and undertakings" (including companies incorporated under the federal *Canada Business Corporations Act*) fall under federal jurisdiction. Hence the overlap in jurisdiction.

an administrative tribunal, as opposed to the court's authority. Some of the legislative sources of the responsibilities for D & O's include:[94]

(a) The *Canadian Human Rights Act*: sets out prohibited grounds of discrimination[95] and associated prohibited discriminatory conduct (including sexual harassment) or policies in relation to wages, access to public facilities, hiring, firing, employment applications, promoting, training etc. Applies to all federal undertakings. Complaints are heard by the Canadian Human Rights Tribunal, which has broad, remedial powers to order payment of damages, reinstatement or accommodation at the workplace.

(b) The *Canada Labour Code*: governs workplace conditions and employment standards, and outlines prohibited conduct other than traditional civil rights violations/discriminatory practices. Regulates labour law, standards for health and safety (including hazardous substances), and employment standards. Complaints and investigations under the Code are brought to/by the Federal Labour Relations Board.

(c) The federal *Employment Equity Act*: attempts to achieve equity amongst all workers in the workplace. Imposes a positive obligation on employers to put a plan in place.

(d) Provincial *Human Rights Codes*: like the federal legislation, list prohibited grounds and conduct. Prohibited grounds vary from province to province so check. Regulated by administrative tribunals in each province. Apply to all non-federal undertakings.

(e) Provincial Employment Standards statutes: mirror the federal legislation to a large degree.

A key feature of EPL claims is that they are brought against employers or fellow employees, usually by other employees, employee applicants or customers, and relate to employment conduct, policies or conditions. Specific complaints include allegations that as a result of the conduct, policies or conditions, the claimant:

---

[94] The corresponding U.S. statutes are: *Title VII of the Civil Rights Act of 1964*, the *Civil Rights Act of 1991*, the *Age Discrimination in Employment Act of 1967*, the *Equal Pay Act of 1963*, the *Rehabilitation Act of 1973*, the *Americans With Disabilities Act*, various "whistleblower" statutes, and various state and local laws prohibiting discrimination in employment and housing.

[95] Section 3. (1) stipulates: "For the purposes of this Act, race, national or ethnic origin, colour, religion, age, sex, marital status, family status, disability and conviction for which a pardon has been granted are prohibited grounds for discrimination." Section 3. (2) provides: "Where the ground of discrimination is pregnancy or child-birth, the discrimination shall be deemed to be in the ground of sex."

(a) failed to get a job
(b) lost his or her job (whether by express or constructive means)
(c) failed to be advanced or promoted
(d) received a lower level of compensation than they were otherwise entitled to
(e) caused them to be subject to a hostile, humiliating, distressing or harmful environment or actor.

EPL claims typically name not just the perpetrator of the harmful conduct, but also name the employer organization or the supervisors, directors or officers of the company. Allegations include vicarious liability, negligent supervision or policy-making - in other words, "allowing" the conduct or practice to take place.

The relief sought in EPL claims ranges from monetary or compensatory damages, to reinstatement, declaratory relief, apologies, changes to workplace policies, practices, and structures, to punitive and exemplary damages.

IX. SEVERITY AND FREQUENCY OF EPL CLAIMS (2014 UPDATE)

While it is difficult to know exactly with what frequency EPL claims are arising in Canada and in the United States, or what the scope of monetary awards is, all indications seem to be that EPL claims are on the rise, on both scales.

Commentary in the U.S. publication, *Best's Review*, estimated for the United States:

> *"In 1995, there were 87,529 charges of sexual, racial, age and other forms of discrimination filed against all types of corporations, non-profit organizations and government agencies with the U.S. Equal Employment Opportunity Commission (EEOC). That's a 41% increase over 1990's charges. USA Today puts the number at more than 150,000 a year based on complaints filed with the EEOC and state agencies."*[96]

In Canada, on the other hand, both the frequency of EPL claims and the severity of the awards are much less, even taking into account the difference in the size of the population. Recently, the authors' firm compiled a summary study of EPL claims[97] decisions in Canada, both at the administrative and Court levels. The summary study revealed that between 1997 and 2002, only 210 cases were reported in standard law

---

[96] Charles Luchs, "Small Companies, Large Exposures", *Best's Review* (January 1997): 82
[97] Please note that this summary review did *not* account for pure "wrongful dismissal" claims alleging a failure to pay salary in lieu of reasonable notice but without any other claim for an EPL "wrong".

reporter series, 166 being "administrative law" decisions and 44 being Court decisions. A full 81% of the decisions resulted in damage awards of $25,000 or less. Approximately 37% of the decisions resulted in damage awards of $5,000 or less. Only 7% of the decisions resulted in damage awards of over $50,000.

The actual data is reflected in this chart:

Table 1: STATISTICAL DATA ON EMPLOYMENT PRACTICE VIOLATIONS IN CANADA

Source: 166 cases from the *Canadian Human Rights Reporter* (1997 - 2002)

AWARD AMOUNT	*TOTAL CASES*	*% OF TOTAL*
$0.00 - $5,000.00	76	46%
$5,001.00 - $10,000	49	30%
$10,001.00 - $25,000.00	30	18%
$25,001.00 - $50,000.00	9	5%
Over $50,000.00	2	1%

Source: 44 cases from *Canadian Cases on Employment Law* (1997 – 2002)

AWARD AMOUNT	*TOTAL CASES*	*% OF TOTAL*
$0.00 - $5,000.00	1	2%
$5,001.00 - $10,000	0	0%
$10,001.00 - $25,000.00	14	32%
$25,001.00 - $50,000.00	17	39%
Over $50,000.00	12	27%

Combination of two case groups (210 cases)

AWARD AMOUNT	TOTAL CASES	% OF TOTAL
$0.00 - $5,000.00	77	37%
$5,001.00 - $10,000	49	23%
$10,001.00 - $25,000.00	44	21%
$25,001.00 - $50,000.00	26	12%
Over $50,000.00	14	7%

The following two "cases in point" highlight the difference between the situation in the United States and the situation in Canada:

a) In 1997, a B.C. human rights tribunal awarded $8,000.00 as punitive damages to a managerial candidate who had been sexually harassed for over three years.

b) A "typical" U.S. award of $537,000 was made to an employee in respect of "repeated propositions from her supervisor and the display of inappropriate photographs in the workplace"[98]

By comparison to the United States, EPL awards in Canada would seem to be in their infancy! However, in the author's opinion, it seems likely that while the frequency of Canadian EPL claims is likely to increase, the severity of awards is unlikely to ever catch up to American levels.

The reason for this is that the vast majority of Canadian claims are heard by administrative tribunals rather than Courts, whereas in the United States many claims find their way into Court and even to jury trials, which opens the door to very high punitive awards where the jury's sensibility is offended. In contrast, Canadian administrative tribunals are more preoccupied with correcting workplace conditions than awarding substantial damages in any particular case. In Canada, awards for humiliation and distress are nominal (less than $20,000), as are the awards for punitive and exemplary damages.

When claims do find their way into Canadian Courts, very few cases are heard by juries and when juries are used, the trial judge is permitted to give the jury directions as to what would constitute a "typical award" for similar claims. This practice generally results in the judgments remaining more or less consistent with prior (relatively low) awards.

Finally, the overall impression is that the legal culture in Canada is less litigious than it is in the United States. Canadians seem to generally prefer negotiating such claims or walking away, rather than becoming embroiled in an expensive suit. Alternative dispute resolution methods are also embraced in Canada, which will likely mean that disputes of this nature will at least have a good opportunity to be resolved out of court, rather than creating precedents. The tradition of wrongful dismissal law in Canada likely also has had a significant impact on the legal tradition with respect to employment liability. In keeping with the Canadian legal tradition of there being an

[98] *Supra.*, note 4.

implied contract for reasonable notice, "wrongful dismissal" suits in Canada tend to focus not on *why* the employee was dismissed but *what compensation or severance pay* the employee is entitled to in lieu of their entitlement to reasonable notice. The focus in such suits has not been on awarding punitive damages for outrageous behaviour, but rather, reasonable compensatory damages.

D & O Coverage Does Not Respond

The issue in a D & O context, and in a Canadian D & O context in particular, is that while EPL claims against D & O's and employer-companies are rising in number,[99] they are not usually covered under either a traditional D & O policy or a standard Comprehensive General Liability policy.[100] First of all, because most D & O policies are of the corporate reimbursement type, they do not provide "entity" coverage. With respect to the coverage that is specified for D & O's, a standard D & O policy generally defines "wrongful acts" as having the following key features:

(a) a breach of duty, negligence, error, misstatement, misleading statement or omission
(b) done in their capacity as a director or officer
(c) leading to a claim against them solely as a result of their director or officer status

Three exclusion clauses in a standard D & O policy render D & O coverage unresponsive to most EPL claims:

(a) The "Intentional Act" Exclusion: because many EPL claims involve intentional and not simply negligent conduct (such as retaliatory or discriminatory conduct), they are captured by this exclusion.

---

99 The frequency and severity of claims in Canada is still much less than in the United States, but nonetheless it is an area of growing concern for companies and D & O's. Recently, the authors' firm compiled a summary study of EPL claims decisions in Canada, both at the administrative and Court levels. The summary study revealed that between 1980 and 1997, only 135 cases were reported in standard law reporter series, 96 being "administrative law" decisions, and 39 being Court decisions. A full 80% of the decisions resulted in awards of $25,000 or lower. Approximately 51% resulted in damages awards of $5,000 or less. The highest award reported was a 1993 decision of the Canadian Human Rights Tribunal awarding $152,015 to an armed forces member who was discharged on grounds of HIV infection. Of that sum, $147,015 related to past and future wage losses and only $5,000 was awarded for hurt feelings. Only two claims, or 1.5% of all of the decisions, resulted in awards larger than $100,000 (Cdn.) . The foregoing does not account for unreported claims.

100 It is not within the scope of this paper to describe in detail why CGL cover is of little assistance. The bullet answer is that by their nature, CGL policies are intended to provide coverage for "non-specific" risks or "accidents", and they invariably exclude employee claims.

(b) The "Bodily Injury" Exclusion: in Canada, "bodily injury" is construed to include emotional and psychological harm (this is not usually so in the United States). Thus, in Canada, this exclusion will act to exclude many claims.

(c) The "Sexual Misconduct" Exclusion: as a result of an onset of claims for coverage for sexual misconduct, D & O wordings have been amended in the last five years to include specific exclusions for sexual misconduct, since in some decisions it has been held that such misconduct is not *per se* intentionally injurious. Given that this leaves open the possibility that such conduct might be covered as "negligent", specific exclusions have been inserted to dispel any notion of coverage for this risk.

The Development of EPL Products

As a result of the gap in coverage, EPL endorsements and programs are being developed in Canada.[101] The key features are discussed below.

(a) Most EPL policies are being written on a "claims made and reported" basis, as opposed to an "occurrence" basis, therefore resembling D & O policies more than CGL policies. In accordance with this "claims made and reported" approach, coverage is triggered by:

(i) An "EPL Violation" being alleged against an Insured; resulting in

(ii) An EPL Claim being made and reported, during the coverage period, regardless of when the events giving rise to the claim took place

(b) A typical policy defines "Employment Practices Violation" to mean:

...an actual or alleged:

(1) Wrongful Dismissal, discharge or Termination (either actual or constructive) of employment;

[101] Most EPL coverage is being introduced on an endorsement basis added on to D & O cover. There is, however, a growing need for "stand-alone" policies, due to the fact that many companies would prefer to keep their D & O limits separate; there is an inconsistency in the definition of who is an "insured"; and many small, private companies do not carry D & O coverage. The latter is especially problematic, since it is smaller companies which are arguably more vulnerable to claims, given the fact they often do not employ professional human resources staff that would be knowledgeable with respect to managing and preventing EPL problems.

(2) Sexual Harassment or Workplace Harassment of any kind including the alleged creation of a harassing workplace environment;
(3) discrimination;
(4) Retaliation (including lockouts);
(5) employment-related libel, slander, humiliation, defamation or invasion of privacy;
(6) wrongful failure to employ or promote;
(7) wrongful deprivation of career opportunity, wrongful demotion or negligent employee evaluation, including the giving of negative or defamatory statements in connection with an employee reference;
(8) wrongful discipline;
(9) failure to grant tenure;
(10) failure to provide or enforce adequate or consistent employee corporate policies and procedures relating to an Employment Practices Claim;
(11) employment-related wrongful infliction of emotional distress and mental anguish;
(12) misrepresentation to an employee or applicant for employment with the Company, which is connected to, related to, or associated with, an employment relationship alleging matters enumerated above;
(13) violation of an individual's civil rights relating to any of the above,

but only if the Employment Practices Violation relates to an Insured Individual, whether direct, indirect, intentional or unintentional.

With respect to any customer, client or any other individual or group of individuals, other than an Insured Individuals, Employment Practices Violation shall mean only any actual or alleged Sexual Harassment, discrimination or violation of an individual's civil rights relating to such Sexual Harassment or discrimination.

(c) Sexual Harassment is typically defined to mean:

"..unlawful sexual advances and/or requests for sexual favours and/or verbal or physical conduct of a sexual nature against a past, present or prospective employee of the Company that (a) are made a condition of employment and/or (b) are used as a basis for employment decisions and/or (c) create a work environment that interferes with performance."

(d) "Insureds" tend to be in two classes, the individuals and the company. Both D & O's and employees are included under "individuals". The resulting class of insureds is therefore much broader then a standard D & O policy.

(e) Location: the policy may also stipulate *where* the EPL Violation must have taken place. Some EPL policies restrict coverage to acts that took place in the United

States or Canada; others stipulate that they relate to conduct "occurring anywhere in the world".

(f) Formalities: there is still some dispute over the requirement of formalities to an EPL claim. Whereas some policies are being written to cover any "written complaint or demand for compensation" in respect of an EPL Violation, others state that for there to be a claim, there must be formal proceeding.

(g) "Loss": in Canada includes punitive and exemplary damages, pre-judgment and post-judgment interest and civil fines and penalties

(h) Approach to defence costs: EPL insurers are learning that EPL claims can lead to protracted litigation. From either point of view, the issues are "super-charged". On the one hand, from the claimant's point of view, emotional issues are often involved; on the other hand, from the company's point of view, its good reputation may be at stake. In an attempt to manage escalating defence costs, EPL insurers are therefore introducing:

  i) duty to defend clauses;
  ii) clauses providing that counsel must be chosen from a pre-approved "panel"; and
  iii) ADR clauses.

(i) Libel, slander and invasion of privacy: overage for damages related to these kinds of behaviour must be covered, or else the EPL coverage would be negated

(j) Emotional harm and mental distress: must be included for the policy to be effective (in Canada it is to be remembered that such harm is included in the term "bodily injury" - so caution must be taken that when "bodily injuries" are excluded, this kind of harm is specifically *left out* of the exclusion...

(k) Related acts: there is still no unanimity of approach on this point. Arguably, if claims for related acts were treated as multiple claims, with a deductible applied to each, the insured's coverage would be undermined. In the EPL context, "related acts" may arise easily: for example, as in a case of systemic discrimination, or a case for pay equity.

Standard Exclusions

While EPL endorsements are as of yet far from "standard" in their form, there does seem to be a fair bit of unanimity in terms of the exclusions to EPL coverage. These are:

(a) Losses related to workers' compensation obligations, unemployment insurance, social security or old age security, retirement or pension benefits, disability benefits or other similar laws or obligations: for the most part, claims of this nature are excluded because the subject matter is usually otherwise insured under separate cover.

(b) Losses related to being ordered to provide sensitivity training or any other corporate program, policy or seminar relating to any Employment Practice Claim, except as to Defence Costs: these claims are largely considered to be of the "preventative maintenance" version, i.e., not an appropriate matter for insurance

(c) Losses flowing from liability under the contract or agreement, express or implied, oral or written, but not limited to the dismissal of an employee, except to the extent that the Company or Insured Individual would have been liable in the absence of the contract or implied agreement: in Canada, the most common kind of employee-initiated suit is a claim for wrongful dismissal, premised not on an EPL "wrong" per se, but on the Canadian doctrine of "reasonable notice". Whereas in the United States employment is at will of the employer, in Canada, an employer must give reasonable notice of termination or damages in lieu thereof, and a failure to do so may lead to a claim for "damages in lieu of reasonable notice". As this is really a contractual matter and not a matter of tort, some insurers have considered it to be an inappropriate matter for insurance, for if misused, it could amount to "improper firing insurance" for the employer, and not insurance for a "true" wrongful employment practice such as a human rights violation, etc.

(d) Losses related to any (i) future damages or other future economic relief or (ii) any employment-related benefits, stock options, perquisites, deferred compensation or other type of compensation other than salary (including bonuses) or wages: like the claim for wrongful dismissal, deemed an inappropriate matter for insurance by some carriers.

(e) Losses flowing from any actual or alleged act or omission of an Insured Individual serving in any capacity other than as director, officer or employee of the Company: this is the personal acts exclusion, excluding acts unrelated to employment.

(f) Losses associated with modifying premises or otherwise incurring costs to accommodate any disabled person pursuant to an order, direction, certificate or determination under the *Canadian Human Rights Act*, *Employment Equity Act* of Canada or similar provincial legislation or affirmative action program: awards and losses of this nature are rare in Canada, due to the fact that in Canada, the human rights legislation does not speak quite so clearly as the U.S. *American With Disabilities Act* about the need for making capital renovations: such an order would come under the umbrella of a general authority to make whatever order is needed to remedy the discrimination under the circumstances. The other reason for the exclusion is the potentially high cost of capital renovations.

(g) Losses related to pay equity obligations, collective bargaining or employment standards obligations: this exclusion is still under debate as a prominent, but potentially very expensive, EPL risk. Some insurers are choosing to exclude it; others are simply relying on appropriate limits of coverage, or choosing their insureds wisely.

(h) Losses relating to claims for personal injury (other than emotional distress or mental anguish), sickness, disease, or death of any person, or damage to any tangible property including the loss of use thereof: this is a normal exclusion, although it has the potential to leave a gap in coverage.

(i) Losses relating to claims in respect of which an Insured had prior knowledge of circumstances likely to give rise to EPL Claim: sometimes expressed as a condition precedent to coverage in a claims made and reported policy, it is imperative that the claim not arise out of known liabilities occurring prior to the inception of the policy. As discussed above, the wording of the exclusion ("...known to an insured" versus "known to the insured") may be of critical importance to an innocent co-insured.

(j) Losses deemed uninsurable under local or provincial laws (including public policy): as discussed in more detail above, this exclusion is more common in the United States than in Canada.

The underwriting considerations with respect to evaluating individual applicants for EPL coverage are quite broad. A questionnaire in an EPL application form would typically include the following kinds of questions:

- Whether the employees are unionized or non-unionized;
- How many employees, and whether full-time or part-time;
- Jurisdiction of employees (i.e. location of offices);
- Whether buildings are owned or leased, age of buildings, and level of accessibility to disabled persons;
- How many employees above a certain level of compensation;
- Whether employment counsel, in-house or out-of-house, is used;
- Whether there is a human resources department or manager;
- Whether there is an employee handbook and if it is distributed to all employees (provide copy of same);
- Whether there is a human resources manual that is followed (provide copy of same);
- Whether the employee and human resources handbooks were developed in consultation with counsel and address certain key topics such as:
    - Discrimination;
    - Sexual harassment;
    - Confidentiality of complaints;
    - Grounds for termination;
    - Procedures for redress;
    - Services for employees;
    - Procedures for employee review and appraisal;
- Questions with respect to the existence of training of management, and frequency of same;
- Whether there is a written company-wide policy statement in place with respect to discrimination, including sexual harassment, in the workplace and whether it is communicated to employees (provide copy of same);
- Whether any employee has been appointed to be a watch-dog on the company's compliance with human rights legislation;
- Whether there is a procedure in place for grievances;
- Whether there is an "open door" policy in place with respect to employee input into the workplace;
- Questions about the employee application procedure, including the existence and nature of testing, physical examination, screening, qualification and skill demands of potential employees;

- Whether private recruitment firms are used to recruit employees and what steps have been taken to ensure they comply with existing human rights legislation;
- Whether/what arrangements are in place to accommodate disabled employees, both with respect to applications and emergency evacuation from buildings;
- Whether medical records of employees are kept separate from other personnel records and are kept locked, secure and confidential;
- Whether a formal employment application form is used (provide copy of same);
- Whether written and formalized procedures are in place with respect to progressive discipline and record-keeping on discipline of employees;
- Procedures for termination of employees and involvement of human resources personnel;
- Numbers of recent termination's, resignations and retirees;
- Whether restructuring, acquisitions, or lay-offs are planned;
- Whether in such planning, consultants have reviewed such plans for compliance with trust plans or any other benefit plans;
- Details with respect to benefit plan management;
- Details as to nature, quantum, judgment or settlement status of recent lawsuits, claims, administrative proceedings, complaints, including human rights complaints, demand letters received, etc.;
- Existence, status and nature of prior and existing insurance policies;
- Whether the company has been the subject of allegations or investigation into conduct that is alleged to be criminal, anti-trust, or in violation of any copyright, patent, securities, or federal, state or provincial statute;
- Names and affiliations of directors;
- Financial statements; and
- Prior knowledge warranty with respect to facts giving rise to a claim.

With EPL risks, it is not just what the company is doing that matters; it is what it is *not doing* that can equally lead to trouble.

Many companies are looking to insurers and other sources for information on how to reduce their EPL risk. The answer is for the company to conduct a review of its policies and practices and to then take steps to:

- educate staff;
- eliminate known risks, and
- implement practices and procedures that will:

- publicize the company's desire to comply with the legislation;
- ensure that compliance is effective;
- follow up on and record details with respect to both the good practices and the "problem occurrences"; and
- ensure that dialogue with management and staff is open and accessible.

An ounce of prevention is worth a pound of cure. In the D & O liability context, particularly *vis-à-vis* EPL claims, due diligence is a director's best armour to prevent claims, whether common law or statute-based, and whether the company is "for profit" or "not-for-profit". Due diligence is to be encouraged:

> There are a myriad of statutes and regulations, of greater or lesser significance, which may be relevant to the activities of a not-for-profit organization. The best protection for a director of such an organization is to ensure that there are competent, reliable staff, that authority and responsibility are delegated effectively to the staff, that there are appropriate reporting mechanisms, and that systems are periodically reviewed for effectiveness.[102]

X. CONCLUSION: MANAGEMENT THROUGH UNDERSTANDING

As a result of new laws at both the federal and provincial level affecting the scope for personal liability of D & O's in Canada, the Canadian market for D & O insurance products presents a challenge for U.S.-based insurers. A review of the new liabilities confirms that standard D & O policies will not and cannot respond adequately, in large part due to the "intentional act" exclusion and the need to address unique statutory causes of action. From an underwriting management standpoint, the logical step to take is to adjust the range of "losses" and fine-tune the language, to take into account the uniquely Canadian D & O experience.

A lack of statutory regulation, as well as a different claims culture and coverage experience shape the Canadian milieu. In addition, there are significant procedural differences impacting upon D & O actions, as well as at times, a substantive divergence in the common law. The Canadian D & O experience has been influenced by American D & O precedents, but our courts have not followed such precedents blindly, and many issues are still being litigated and decided on distinctly Canadian principles. However, the fact that the two jurisdictions do diverge, opens the door to unique, strategic litigation opportunities in the context of inter-jurisdictional conflicts.

---

[102] Anders I. Qurom, "Directors' Legal and Regulatory Responsibilities", from February 7, 1997 CLE "Charities and Not for Profit Organizations - 1997 Update", p. 6.1.08.

So to conclude: an examination of Canada's D & O environment reveals some unique features. The Canadian D & O market is best approached by striving to understand which D & O insurance traits are particular to Canada, and which are exclusive to the United States. At the underwriting level, this translates into designing and testing new wordings and products. At the claims and litigation level, this means becoming attuned to how the differences might possibly be used to advantage. In every case, underwriters will want to encourage a review of due diligence on the part of D & O's. Using these various approaches, an effective D & O program may be developed and can flourish.