



The Adviser

SPECIAL BULLETIN

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Directors' Insurance - are you covered?

Increasingly there is more responsibility involved in running a business than just keeping customers happy and the profits rolling in. Many company chiefs are often unaware of the personal liability they face in their capacity as director. A common misconception is that being a director of a limited company in some way restricts the director's personal liabilities. This is not the case – directors' personal liabilities are unlimited and, in the course of carrying out everyday duties for a company, directors are exposing themselves personally to lawsuits, investigations and criminal prosecutions.

Until recently, a director was only able to receive indemnity from his or her company for legal costs once they were proven innocent in relation to actions and allegations brought against them. Furthermore, if such allegations were proven and resulted in a civil award, or settlement, this had to be paid personally by the director as the company would be powerless to provide protection.

From April 2004, the Companies (Audit, Investigations and Community Enterprise) Act 2004 resulted in companies being allowed, but not required, to indemnify directors for legal costs, awards and settlements for acts of a civil nature even when allegations are proven. Regardless of the new rules, the key point is that personal liability still exists for directors and, more importantly, the provision of funds to indemnify the director under these rules could seriously affect the profitability of the company. In any event the directors' interests and those of the company are not always compatible. A company will not be willing to provide indemnity to a director with whom it is in conflict with, and any company indemnity would be worthless in cases where the company is insolvent.

The only effective way to offset the risk to both a company's balance sheet, in the case of indemnity to a director, and the personal assets of a director, is to

purchase insurance protection in the form of a Directors' and Officers' Liability policy.

In many cases directors' and officers' claims involve defending directors from spurious or unfounded allegations, incurring significant legal defence costs that would otherwise be picked up by the individual or the company. One leading UK insurer has experienced claims settlements ranging from a few thousand pounds to £300,000 for UK private companies. The same insurer has seen increasing numbers of claims notifications from small and medium-sized companies as directors become the target of a whole range of claimants including employees, creditors, competitors, shareholders and regulatory authorities.

Despite the threat of personal ruin, a recent survey showed that 27% of the UK's SME directors did not know if they had insurance to protect them from being personally culpable in the event of being sued. In today's business environment, Directors' and Officers' Liability insurance is an essential protection, especially when annual premiums start from as little as £350 and stand-alone policies do not incur any "benefit in kind" tax liability on the individual.

Special Bulletin Direct Exposure

Claims Examples

The following claims are typical of those being handled by UK insurers.

Distribution Company

Claim for unfair and constructive dismissal against the Finance Director of a distribution company by a former employee alleging sexual harassment and other inappropriate activity (sending text messages out of working hours, inviting her on nights out etc).

Costs £21,000

Manufacturing Company

Action against directors of a manufacturing company by the Health and Safety Executive following their refusal to respond to a notice to control dust emissions. The directors responsible had failed to adhere to deadlines so action was taken against both the company and the directors responsible.

Costs over £110,000, with a further £60,000 outstanding

Glass Manufacturers

Action taken against the directors of a glass manufacturing company by Trading Standards following allegations of pre stamping of safety glass before it had passed the necessary testing procedure.

Costs incurred £25,700

Engineers

Engineering manufacturers entered into a factoring agreement with the claimant, but following the company going into administration, it was alleged that they used the monies due to the claimant to pay other creditors.

Director Personally Sued £300,000

Cutlery and Giftware Manufacturer

Contractual dispute following appointment of a website developer to design an online trading website for a giftware manufacturer. The director concerned was not authorized to enter into the contract and the company cancelled the agreement.

Website developers claimed against the director for their costs incurred to date of £48,000

Waste Management Company

Transport manager of a waste management company prosecuted by the Crown Prosecution Service following an accident involving an un-roadworthy vehicle operated by the company.

Potential Costs £15,000

