

Directors & Officers Liability Insurance

Below are some examples of the types of claims that directors and officers of a company could face and the potentially disastrous outcomes that such claims could have both on the companies they work for and on the directors or officers personally. These examples are hypothetical but are based on claims that have actually occurred.

Misleading & Deceptive Conduct

XYZ Ltd was a company of widget manufacturers. In 2006 they decided to list on the stock exchange in order to fund their expansion into manufacturing in China. With the help of advisers, they produced a Prospectus which contained financial forecasts that the company directors thought they could expect over the next year.

At the end of the year XYZ's revenue was below the financial forecasts contained in the Prospectus. Subsequently investors lodged a claim for misleading and deceptive conduct against the directors of XYZ Ltd for the statements made in their Prospectus. The matter went to trial and the directors were found to have engaged in misleading and deceptive conduct under the Trade Practices Act 1974. The directors were ordered to pay damages of \$10,000,000, on top of this they incurred \$1,000,000 in legal fees in defending the claim.

Attendance at an Official Inquiry

On a single day in 2006, the share price of Bumper Ltd (Bumper) fell 8%. The movement was not accompanied by any announcements from the company or any news about the company in the media and the ASX index closed higher on the day. Subsequent to this large single day variance, the market remained skeptical of the company initially but the price recovered to the initial level after a month and traded higher thereafter.

One month after the event a formal notice under section 30 of the Australian Securities and Investment Commission Act was received from ASIC requiring the Bumper directors to provide a written explanation of the event and their perceived reasons behind the unexplained movement. A letter was sent by the directors to ASIC stating that they were unaware of any reason for the move in share price. ASIC called the directors before an inquiry into the event. After notifying their insurer, the directors attended the inquiry accompanied by legal support.

The inquiry never alleged any wrongdoing by the directors or Bumper. ASIC declared that it was happy with the results of the inquiry and the matter was considered closed. The directors incurred \$80,000 in legal fees in preparing for and attending the enquiry with their legal representatives.

Insider Trading

Junior Metals Ltd (Junior) discovered a reasonable sized minerals deposit in outback Australia on a small property adjacent to a large property owned by Mega Metals Ltd (Mega), a large public mining company. The land was not in use by Mega as they had not conducted any exploration yet. Frank N Sense, a director of Junior, decided that since their mineral discovery meant that the Mega land probably held a significant deposit, and that he was not a director or officer of Mega, or in any way connected with Mega, that he could buy a number of shares in Mega, announce the minerals find on his own land and benefit from the rise in value of Mega's shares.

He bought 1,000,000 shares in Mega on the 1st of January and announced the minerals find on Junior's land. The next day Mega's stock price gained \$0.10 and Frank made \$100,000. Frank N Sense was investigated by ASIC. He incurred \$100,000 in legal fees in attending the enquiry. He was then prosecuted for insider trading and eventually found not guilty, he incurred a further \$200,000 in legal fees in defending the insider trading allegations.

Insolvent Trading

Explorer Metals Ltd (Explorer) was a small, publically listed exploration company specialising in gold exploration. Explorer had a market capitalisation of \$50,000,000 and debt of \$10,000,000. In December Explorer decided to engage in exploration in Papua New Guinea and hired contractors to undertake preliminary drilling. Before the contract was signed the price of gold fell sharply causing the value of Explorer to drop. Eventually the company was forced to declare bankruptcy.

A claim was lodged by the liquidators alleging that the directors had continued to trade whilst the company was in fact insolvent. Ultimately the claim was settled without going to trial for a payment of \$1,000,000 to the liquidators and with \$500,000 in legal fees.

Mergers & Acquisitions

Mr Small owned a manufacturing company that had been family run for over 30 years. Mr Small decided to sell his business to a large conglomerate before his retirement. Before putting the business up for sale Mr Small retained a consulting firm to provide valuation of the company. The firm used materials and statements provided by Mr Small to provide a value based on the revenue stream expected in the future. Mr Small had never retained an auditor over the company's past. Mr Small sold his business for \$3,000,000 in 2002.

By 2005 demand for the product of the company had slumped and forensic accountants were going through the records. They concluded that the revenue figures prior to the acquisition had been inflated. The conglomerate sought damages from Mr Small and the consultants providing the valuation, for misleading and deceptive conduct that was in breach of the Trade Practices Act. The consultants were able to argue that their valuation was based on the figures provided, and successfully defended the claim.

Mr Small incurred \$200,000 in defence costs and was liable to pay \$1,000,000 in damages.

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