

INSURANCE & REINSURANCE

DIRECTORS' AND OFFICERS' LIABILITY ISSUES IN INDIA

Some like it hot - are policyholders ordering a korma or a phaal?

With the growth in the Indian economy expected to surpass that of the US and China by 2020, more Indian companies listing on foreign stock exchanges and acquiring or merging with non-Indian companies, it is unsurprising that there has been a significant increase in the take up of directors' and officers' (D&O) insurance. Statistics suggest that the Asian D&O market generated premiums of approximately £250 million sterling in 2010 which has been fuelled not just by recent high profile scandals such as Citibank and Satyam, but also increased judicial and regulatory scrutiny by the Indian regulatory authorities.

Main features of a D&O policy subject to Indian law

The starting point for underwriters is normally a US form of D&O wording, but there are several features which are novel to a D&O policy subject to Indian law, which underwriters' should be aware of.

First, it is the role of the person and not his/her title which determines whether or not s/he is a director or officer.

Secondly, the definition of "Officer" will normally include "Managers" who are managing the affairs of the company.

Thirdly, defence costs cannot be advanced by Underwriters. Both Underwriters and policyholders should be acutely aware of section 201 of the Companies Act 1956, which states:

"Save as provided in this section, any provision, whether contained in the articles of a company or in an agreement with a company or in any other instrument, for exempting any officer of the company or any person employed by the company as auditor from, or indemnifying him against, any liability which, by virtue of any rule of law, would otherwise attach to him in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void:

"Provided that a company may, in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or discharged..."

This provision was clarified by the Department of Company Affairs in Vide Circular: No. 8/72(12/42/71 CI-V, dated 8 May 1972):

"...it is not permitted to a company to make its funds available to the managing directors, etc., in connection with any civil or criminal case instituted against them unless they are found by a competent court to be innocent and the question of reimbursement will arise only after the termination of the proceeding in favour of the officers of the company concerned".

As is evident from these provisions, whereas several jurisdictions provide for the advance payment of defence costs in defending directors in civil, criminal or regulatory proceedings, Indian law does not. Any payment to a director or officer before there has been a finding in the directors' favour is in violation of section 201 of the Companies Act and will be void. This prevents a company (and underwriters) from indemnifying directors for defence costs if there are allegations of negligence, default, misfeasance, breach of duty or breach of trust.

Claimants in a typical Indian D&O litigation

India is not a particularly litigious country but the growing importance of communication to shareholders and investors and the transparency of the information available to domestic as well as overseas regulators has seen a spike in claims brought by shareholders in 2010 (42%). The actions arise out of mergers, takeovers, and financial disclosures. The next biggest category of claimants is employees (32%), bringing actions for wrongful termination, sexual harassment and discrimination. The balance is made up of claims initiated by the regulators.

What to look out for when underwriting an Indian D&O policy

There are a number of domestic and global developments which underwriters should have in mind when considering a proposal from Indian companies with US/UK exposure.

An obvious example is the UK Bribery Act and the US FCPA which both have extraterritorial reach, and some commentators are of the view that the UK Bribery Act's reach is more expansive. India is high on the Transparency Corruption Index and while the Indian Government has given into public pressure to sign into law a recent bill condemning bribery it will

take some time for that law to be implemented by Indian companies. Underwriters should review the legislation and ask questions relating to whether the various procedures and controls to prevent bribery have been put into place.

Currently, only 10% of Indian listed companies have purchased a D&O policy and while it is not compulsory for listed companies in India to have a D&O policy, post Satyam, the Ministry of Corporate Affairs (MCA) and the Company Law Board (CLB), which are two of the bodies responsible for corporate governance, are looking at ways to ensure that all public companies put into place measures which can shield them from the risk of liabilities in the event of poor corporate governance. It would be worthwhile for underwriters to review the website of the Securities and Exchange Board of India (www.sebi.gov.in) and identify if any measures are afoot which the companies need to abide by before accepting a proposal.

Again in response to Satyam, some insurance companies are planning to extend the insurance cover to the relatives of the directors and officers such as children or a nominee as well as provide cover for medical treatment which an insured requires in response to allegations of wrongdoing such as depression. Underwriters should therefore expect such requests going forward.

How hot is the Indian D&O market now?

With Indian companies expanding overseas and potential exposures outside India leading to prohibitive legal costs, the Indian D&O market could get very hot indeed. However, the main issue which the Indian Government has to look at urgently is the general prohibition on a company unable to indemnify directors and officers for their defence costs, which makes them, at this time, personally liable for their own defence costs until such time as they are found to be innocent or the allegations are withdrawn. Once the Indian Companies Act is amended to reflect the ability to advance defence costs then there is no question that the D&O product in India will become even more attractive.



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