



INDIVIDUAL

Deed of indemnity

A deed of indemnity is a contractual agreement between a company and a company director. A deed of indemnity can help to indemnify a director against liabilities or legal costs incurred in his or her professional capacity as a director of the company. It also commonly deals with matters such as access to documents and insurance.

A company director is subject to many legal duties. A breach of those duties for any reason, intentional or otherwise, may result in the director incurring either a liability – for example, a damages judgment – or legal costs to defend a claim. The director may also become involved in a regulatory investigation by bodies such as the Australian Securities and Investments Commission (ASIC).

In some circumstances the company's constitution may provide an indemnity to a director. However, as the constitution can be amended without the director's specific consent, it is preferable for a director to enter into a separate deed with the company to provide protection for a director, particularly for that period of time after they cease serving as a director of the company.

The scope of each deed of indemnity will depend on the position agreed by the company and the director. It is therefore prudent for the director to obtain independent legal advice before entering the deed of indemnity.

What is usually covered in a deed of indemnity?

A typical deed of indemnity is structured in the following way:

- **Recitals** – these describe the background to the deed, including the date the director was appointed;
- **Definitions** – these cover key contractual terms such as 'papers', 'claim' and 'liability';
- **Access to documents** – these clauses often cover the rights and obligations of the parties in relation to company documents and related matters, including matters such as confidentiality and legal professional privilege;
- **Indemnity** – the indemnity clauses detail the scope of the company's indemnity in favour of the director and the rights and obligations of the parties in the event that a party seeks to rely on the indemnity;
- **Insurance** – the insurance clauses deal with the parties' rights and obligations in relation to directors' and officers' (D&O) liability insurance which can include the type and term of insurance cover to be maintained;
- **Legal 'boilerplate' clauses** – these clauses cover areas such as governing law and notice provisions; and
- **Execution clause** – this clause is found at the end of the deed (but usually before any schedules or annexures) for signature by the director and a representative of the company.

In a corporate group context, it is common for directors of the holding company and subsidiaries to receive an indemnity from the holding company (or sometimes the main operating subsidiary) rather than each subsidiary entering into separate deeds with its directors. Where this occurs, the legal restrictions on the scope of the indemnity are noted below (see Restrictions on indemnity, below).

The contents of a typical deed of indemnity

Access to documents

The deed should require the company to retain appropriate company records so that the director has access to relevant documents in the event of a claim.

Directors have the right to access company documents under the *Corporations Act 2001* (Cth) (the Act) however these rights of access can be affected by whether the director is currently sitting on the company's board or not. Deeds of indemnity can reflect the statutory position in the Act or provide access to a broader or narrower range of documents. At a minimum, a director should be able to access all board papers, minutes, memoranda and legal opinions provided to the board during the period he or she served as a director, including financial statements, subcommittee papers and advices and documents referred to in those documents.

Companies are often reluctant to provide directors with unfettered access to company documents. The right of access is commonly triggered by a claim, proceedings or regulatory investigation, so it is preferable that the terms of access are broadly defined and include civil, criminal or administrative claims, either commenced or threatened, and regulatory proceedings or investigations.

Access to documents is usually provided for a period of seven years after the person ceases to be a director, or up to the conclusion of any claim or proceedings if this takes longer.

Deeds of indemnity often also cover:

- ownership of the documents, which is typically retained by the company;
- confidentiality; and
- a process to preserve legal professional privilege in legal advices or any other communications between the company and its lawyers.

Indemnity

Many deeds provide indemnity 'to the maximum extent permitted by law'. This is the best option for a director.

Some deeds specifically reference the legal restrictions referred to below (see Restrictions on indemnity, below) or introduce additional restrictions.

Ideally, from a director's perspective, the company will indemnify the director for all claims arising from any acts or omissions and the indemnity will not be limited by time. However, companies may seek to impose a limit on the indemnity of seven years after a director leaves which reflects the usual limitation periods in civil claims.

It is also ideal for a deed to provide for legal costs to be indemnified as they arise or in advance rather than once the claim is resolved as this can leave the director exposed to significant legal bills while the claim is in process. For example, the claim could be resolved as a result of a judgement handed down by a court after a full trial.

When a company pays a director's legal costs it frequently acquires rights in relation to the conduct of the claim – typically it will either control the defence of a claim or have a right to 'associate' in the defence of a claim. There can be sound reasons for this – for example, co-ordinating the defence of claims against multiple directors can be more efficient and less costly. However, there is a balancing act between the interests of the company and those of the director. A common compromise is for the company to control the defence of a claim against one or more directors subject to certain provisions. These might include a:

- requirement for the company to have regard to potential damage to a director's reputation;
- requirement for the director's consent to the settlement of a claim;
- right for the director to engage separate legal representation, which would be paid for by the company, in the event of a conflict of interest with the company or another director.

Restrictions on indemnity

The scope of the indemnity will depend on the terms of the deed negotiated between the company and the director. A company may indemnify a director for liabilities and costs incurred while acting as a

director of the company, however this is subject to the restrictions in relation to liabilities in s 199A (2) of the Act, which provides that a company must not indemnify a director against:

- a liability owed to the company or a related body corporate;
- a liability for certain pecuniary penalty orders or compensation orders;
- a liability that is owed to someone other than the company or a related body corporate and did not arise out of conduct in good faith.

As to legal costs, s 199A (3) provides that a company must not indemnify against legal costs if the costs are incurred:

- in defending or resisting proceedings in which the director is found to have a liability for which they could not be indemnified by reason of s 199A (2) above;
- in defending or resisting criminal proceedings in which the director is found guilty;
- in defending or resisting proceedings brought by ASIC or a liquidator for a court order if the grounds for making the order are found by the court to have been established.

Although a company is prohibited from indemnifying a director for some liabilities such as fraud, companies can advance defence costs to defend claims alleging these matters provided that these costs are repaid if the director is not successful in defending the claim. Companies can also pay premiums for insurance relating to many of these liabilities.

D&O insurance

Directors and officers (D&O) insurance indemnifies a director for liabilities incurred in the role of director.

It is similar to a deed of indemnity but provides important additional protection where the company:

- is legally prohibited from indemnifying a director;
- decides not to indemnify a director; and/or
- is unable to indemnify a director because, for example, it is insolvent.

Except in a small number of circumstances, a company is permitted to pay the premium for a director's D&O insurance policy. As a result, deeds of indemnity commonly deal with rights and obligations relating to D&O insurance.

The D&O insurance should address the following key areas:

- The primary obligation of the company to ensure continuity of cover for the director by procuring and maintaining D&O insurance. This obligation will usually continue for seven years after a director ceases to serve as a director for the company.
- The scope and terms of the D&O insurance. This will ordinarily require that the terms of the policy are consistent with the coverage obtained by comparable companies. The deed may also deal with the financial limits of the D&O insurances – again with reference to comparable companies – and the minimum-security rating of the D&O insurer.
- The ongoing rights and obligations of both parties. These can include:
 - The right of a director to obtain a copy of the D&O policy and a certificate of currency;
 - An obligation for the director to provide information required by the company to obtain the D&O insurance – for example for the purposes of disclosure to the insurer;
 - An obligation for the company to do nothing which prejudices a director's rights under the D&O insurance.

Research suggests¹ the top five D&O claims in recent years are:

1. Errors or misstatements in reporting and disclosure documents – for example, in prospectus and other capital-raising documents.
2. Company administration – when a company in financial difficulty is sold off or broken up and enters administration (often banks bring legal action).
3. Insolvency – when a company goes into insolvency due to financial difficulty, any creditor can bring a legal action.
4. Regulatory inquiries and investigations brought by ASIC, APRA or the ACCC.
5. Employment practice claims, such as sexual harassment, wrongful dismissal, failure to promote a worker.

There are many new and emerging risks that can lead to legal actions and claims. These new risks include damage as a result of cyber-attack, breach of privacy, environmental liability, employment practice liability,

1. S Dempsey, 2018, "Class actions: Top 5 liability claims for directors", *Membership Update*, Australian Institute of Company Directors, 28 November, <http://aicd.companydirectors.com.au/membership/membership-update/class-actions-top-5-liability-claims-directors>, (accessed 2 April 2019).

and other disclosure and regulatory issues. Company directors should consider their personal risk appetite to ensure any material business risks are captured in the relevant deed of indemnity and insurance policy.

Checklist to assist with reviewing deeds of indemnity and D&O insurance

The following simple, ten-question checklist² may assist directors reviewing a deed of indemnity and D&O insurance:

1. Do I have a copy of the company deed of indemnity?
2. Do I have a copy of the directors or officers liability insurance policy wording (D&O policy)?
3. Am I listed (by name or role) as an insured under the D&O policy?
4. What risks, errors and claims does the D&O policy cover me for?

5. Does the policy cover me for the period of time I need it to cover me?
6. Are the policy limits (\$A) appropriate?
7. Is the D&O policy the right product for me and my company (for example, public, private, listed or not for profit)?
8. What are the common extensions to policy coverage and are there any needs specific to my industry or circumstances that should be specifically addressed in my D&O coverage?
9. Are there any exclusions that I am not comfortable with?
10. What should I do when there is a claim?

Deeds of indemnity and D&O insurance can raise complex issues and it is therefore prudent for directors or potential directors to obtain independent legal advice on their personal situation.

2. C Stewart, 2018, "D&O Decoded", *Membership Update*, Australian Institute of Company Director, April, <http://aicd.companydirectors.com.au/membership/company-director-magazine/2018-back-editions/april/d-and-o-decoded>, (accessed 2 April 2019).

About us

The Australian Institute of Company Directors (AICD) is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership includes directors and senior leaders from business, government and the not-for-profit (NFP) sectors.

For more information **t: 1300 739 119** **w: companydirectors.com.au**

Disclaimer

This document is part of a Director Tools series prepared by the Australian Institute of Company Directors. This series has been designed to provide general background information and as a starting point for undertaking a board-related activity. It is not designed to replace legal advice or a detailed review of the subject matter. The material in this document does not constitute legal, accounting or other professional advice. While reasonable care has been taken in its preparation, the Australian Institute of Company Directors does not make any express or implied representations or warranties as to the completeness, currency, reliability or accuracy of the material in this document. This document should not be used or relied upon as a substitute for professional advice or as a basis for formulating business decisions. To the extent permitted by law, the Australian Institute of Company Directors excludes all liability for any loss or damage arising out of the use of the material in this document. Any links to third-party websites are provided for convenience only and do not represent endorsement, sponsorship or approval of those third parties, or any products and/or services offered by third parties, or any comment on the accuracy or currency of the information included in third party websites. The opinions of those quoted do not necessarily represent the view of the Australian Institute of Company Directors.

© 2020 Australian Institute of Company Directors