

RUSSIA / EURASIA

Executive Guide

WorldTrade Executive, Inc.

The International
Business Information
Source™

Regional Coverage Including Legal, Tax and Financial Developments

February 2009
Volume 19, Number 2

Forearmed is Forewarned in Russia: Questions Every Director Should Be Asking

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There are many considerations involved in the implementation of a comprehensive directors' and officers' ("D&O") liability and indemnification programme under Russian law. Issues such as enforceability, law and jurisdiction and the application of the foreign element test are just some of the problems that have been identified and, indeed, discussed in previous editions of this publication.

Boards often approach the issue of managing potential liability on a fragmented basis meaning that gaps may exist between protections. Indemnification and insurance can be very valuable assets and a thorough interrogation of the applicable language is therefore critical to ensuring that the protection provided adequately meets the needs and expectations of the board. Design of insurance and indemnification programmes can no longer be based on boilerplate forms: Subtle wording changes can make the difference between having coverage and no coverage.

Particular issues arise for multinational corporations, companies with foreign non-executive directors on their boards, private equity firms and in connection with change of control transactions and many clients are now proactively seeking to close any gaps in their protections. Below are some frequently asked questions regarding indemnification and insurance which may provide a helpful checklist when assessing coverage. These are some of the questions you want answered *before* you are facing a regulatory investigation and/or litigation. Once an investigation and/or litigation is underway, it will be too late.

What is the scope of indemnification (if any) that directors are entitled to? Are separate indemnity agreements an option?

The law on indemnification in Russia is silent both generally and specifically as it relates to directors' liabilities. Arguably, there are no legal limits on the types of liability for which directors can be indemnified.

Separate indemnification agreements may be an option, to provide some comfort and clarity in respect of what indemnification rights are available (subject ultimately to recognition under the law).

Is a local Russian policy required?

It is a violation of Russian law for a global directors and officers policy, issued to e.g., the parent company in another jurisdiction, to make payment to local directors. Directors are often surprised to find out that they are not covered by the parent's global directors and officers policy: Rather, Russian law dictates that coverage be purchased locally. Moreover, if a foreign insurer endorses the policy, it may threaten the entire policy, since government authorities are likely to find the policy void for illegality.

What law and jurisdiction prevails under the policy?

The compulsory execution of a policy by a Russian carrier will have an impact on the governing law of the contract. If Russian law prevails, then this could give rise to many issues in terms of compliance with and enforcement under Russian law as the policy is usually drafted by UK/US lawyers. However, in most cases, foreign directors will wish to have the comfort and familiarity of, for example, English law and the policy will need to be structured in such a way as to give effect to such intentions. There may still be a remote risk that the insurer will have to adhere to certain mandatory provisions of Russian insurance law, for example, Russian law does not permit insurance for administrative or criminal penalties imposed on a director or officer.

Does your directors and officers insurance policy cover investigations? Under what circumstances? Are the triggers for the investigative coverage broad enough?

Unless specifically negotiated and carefully worded, many directors and officers policies do not cover investigations, or provide very limited coverage. The insured needs to ensure that the formal triggers providing

for investigative coverage are not unnecessarily restrictive. The definition of claim must take into account the types of investigations that may occur across a wide variety of jurisdictions, including Russia, in order for coverage to apply.

Are advancement of defence expenses mandatory or discretionary?

If advancement of expenses is discretionary, D&O policies will presume advancement has been made. Therefore, the policy needs to be properly amended to account for advancement of expenses as provided for in the underlying indemnities. If not, the director or officer may be forced to pay those expenses out of pocket. Also, the policy must clearly state that defence expenses will be advanced within a set time period, or the director may wait months for out-of-pocket fees to be paid.

Are adequate bankruptcy provisions provided within the policy to provide protection of the policy assets in the event of insolvency?

The insured should request specific language addressing what will happen to the policy in the event of a bankruptcy under Russian law. Ultimately, the language should be helpful in making sure the policy proceeds are used for the primary benefit of the directors. This is critical so that directors can access coverage when they need it the most.

How clear are the notification requirements under your directors and officers insurance policy?

Often, if the claim notification requirements in a policy are not closely adhered to, coverage will be compromised, or void. These provisions can be modified to provide the directors more flexibility when reporting a claim.

Is the policy severable?

If a D&O policy does not include a severability clause or where the insureds are not identified as composite, any fraud, non-disclosures or misrepresentations in the insurance application or elsewhere by one insured party may be imputed to all other insured parties, resulting in a complete loss of coverage for all parties, innocent and guilty alike.

Under a properly worded severability provision, the insurer treats each covered party separately, such that the acts or omissions of one insured party do not impact the others, thereby mitigating the risk of the whole policy being avoided by the insurer.

Is the language used in the excess policies consistent with that in the primary?

A company will often have additional layers of coverage in place which incorporates the terms and conditions of a number of insurance carriers. It is necessary to review each of these policy wordings to ensure that definitions conform and that there are no additional exclusions or variations between the different layers. In addition, if the excess policies are not carefully drafted to account for contribution towards settlement by the insured, the Insured may not be able to access coverage beyond the primary policy.

Are you aware of the personal tax implications for directors in respect of payments made under an indemnification agreement and/or a directors and officers' insurance policy?

Under the Russian Tax Code, taxable income for individual assessment purposes comprises all income received by the taxpayer including compensation received by board members. As a result, directors need to evaluate whether they will be facing a potentially significant tax liability in respect of any payments received from the company as an indemnity, or from the D&O insurers in respect of a covered claim. In the latter case, it may be possible for payment to be paid directly to an injured third party which may alleviate such a burden but this would need to be explored in light of the facts, which are of course specific to each case.

The issues concerning coverage and the enforceability of D&O insurance and indemnification agreements are complex and fraught with legal uncertainty and this article only highlights some of the issues that frequently arise. The role of a lawyer is therefore a critical one not only to advise on the substantive issues of law but also to modify policy language in order to provide innovative solutions ensuring broad and appropriate coverage for executives sitting on Russian company boards.

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