



Directors & Officers Insurance Coverage: What Every General Counsel and Risk Manager Should Know

A D&O POLICY PROVIDES PROTECTION FOR LOSSES DUE TO WRONGFUL ACTS OF OFFICERS

The D&O policy is designed to protect directors, officers, and potentially the company itself, from losses due to the wrongful acts of those individuals who make the company’s decisions. While a good decision can lead to a rise in stock and capital for the shareholders and employees, a poor decision may lead to a lawsuit against the directors, the company or both. There are three separate components to the D&O policy:

- **Part A** directly covers the directors and officers for losses, including the cost of defense. Each individual director and officer is an insured. The policy typically will define who is an “insured person.”
- **Part B** is designed to reimburse the company for money paid as indemnification to insured directors and officers. If the company has paid out of pocket, this section of the policy allows the company to recover its losses.
- **Part C** is an optional provision that covers the company itself in certain circumstances, even if no director is named as a defendant. This is known as “entity coverage” and can be either a part of the policy or attached to the policy as an endorsement.

TYPICAL COVERAGE ISSUES UNDER D&O POLICIES

Severability	Shared Limits (if Part C coverage is purchased)	Bankruptcy
<ul style="list-style-type: none"> • Severability becomes significant when one of your directors or officers engages in an act during the purchase of the policy that, when discovered, renders the policy invalid. The absence of a severability clause can lead to the devastating result of a policy rescission, leaving all directors and officers uncovered and exposed. • Make sure to request severability language in the D&O policy to avoid possible future conflict and rescission. of the entire policy. 	<ul style="list-style-type: none"> • Require language that allocates policy limits exclusively for the protection of your directors and officers, indicating how much should be allocated to them as opposed to the company itself. • Know whether defense costs erode the limit of liability and what excess D&O coverage is available. 	<ul style="list-style-type: none"> • You should prevent your D&O policy from being considered an asset of the corporate estate in the event of bankruptcy; it is designed to protect, not further burden, your directors and officers. • Make sure to include a “priority of payments” provision to aid in the protection of your directors and officers.
Defense Costs	Insured v. Insured Exclusion	Understand what constitutes
<ul style="list-style-type: none"> • If your insurer hires your defense attorney, request the option to pre-approve the insurer’s choice of defense counsel. • If you hire your own attorney and are forced to pay defense costs up front then later seek reimbursement from your insurer, you should require policy language that specifies <i>when</i> the insurer must reimburse the directors and officers for the defense costs incurred. 	<ul style="list-style-type: none"> • This exclusion addresses what happens when one insured sues another insured to recoup consequences of business mistakes and provides that there <i>should be no coverage</i> in such instances. • D&O coverage is maybe not available when an insured sues another insured to recoup losses. 	<ul style="list-style-type: none"> • A “claim” can be limited to a court filing. • A “claim” can also be the predecessor to a court filing. For example, an investigation by the Securities and Exchange Commission or the Environment Protection Agency into the company’s practices. • Such investigations typically lead to the expenditure of costs and legal fees on behalf of directors and officers, so those costs fall under what one would expect the D&O policy to cover.

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IMPORTANT TIPS TO REMEMBER

Typical coverages afforded under a D&O policy:

- **Duty to Indemnify:** The duty to indemnify obligates the insurer to pay for all claims, expenses and damages that the insured becomes legally obligated to pay for any claim(s) first made against the insured for a wrongful act (s) which arise solely out of the discharge of an individual insured’s duties.
- **Duty to Defend:** The duty to defend obligates the insurer to defend any covered claim against the insured, even if such claim is groundless, false or fraudulent. Defense fees usually erode policy limits.
- **Allocation of Defense fees** between covered and uncovered claims frequently results in disputes with insurer.

Immediately Provide Notice to All Insurers

- Timely notice is always an issue in coverage cases.
- Give notice as soon as practicable after learning of a potentially covered claim.
- Insurers routinely deny coverage by alleging late notice.
- Timely notice is even more important under D&O policies because they are typically “claims made” policies.
- If the insurer does not timely disclaim coverage after late notice, it may waive its right to assert late notice as a defense to coverage.

Typical requirements for coverage under a D&O policy:

- **Notice:** The insured is obligated to provide the insurer with “prompt written notice.” Notice may be required within the policy year or during an Extended Reporting Period.
- **Notice of a “potential claim”** can preserve coverage under an earlier year’s coverage.
- **Claims Made Provision:** In order for coverage to be afforded, the claim must first be made against the insured during the policy year.
- **Retroactive Date:** This condition typically requires that the event which results in a claim occur after a specific retroactive date.

Insurance Coverage Litigation: What to Expect

- Breach of contract claims
- Declaratory judgment actions
- Bad faith claims
- Unfair Trade Practices Act claims
- Unfair Insurance Practices Act claims
- Choice of law issues
- Choice of venue issues
- Contra Proferentum-ambiguity issues
- Reservation of rights/disclaimer issues
- Voluminous special defenses