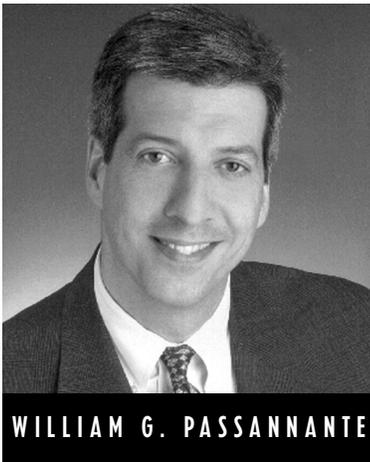


D&O Liability Insurance And Corporate Governance: A Match Made In Heaven?



How can you help your directors and officers to sleep easier at night? Understanding the duties and defenses relating to the actions of directors and officers may ease the defense of claims against them. Further, properly managing your D&O liability insurance helps to maximize the value of your D&O insurance policies. Additionally, good corporate governance practices coupled with an active and informed approach to your D&O liability insurance is a multifaceted approach to reducing D&O exposure.

I. Duties of Officers and Directors and The Business Judgment Rule

Several duties of corporate directors and officers under common law or statute

give rise to assertions of breach of duty. For example, directors are subject to duties of : (1) loyalty; (2) diligence; and (3) candor. Claims against directors and officers may involve allegations of the breach of these and other duties.

The duty of loyalty has been held to require an unselfish and undivided loyalty to the corporation without a conflict with self-interest.

The duty of diligence has been described as requiring that a director or officer discharge her responsibilities with that level of care that an ordinary prudent person would exercise under similar circumstances. Put another way, directors and officers also must reasonably inform themselves prior to making decisions.

The duty of candor gives rise to responsibility to disclose candidly material information in the board's control when seeking shareholder approval of a corporate action.

The so-called "business judgment rule" protects corporate officers and directors in their decision making. Loosely put, so long as an officer or director acts in good faith and does not engage in conduct rising to the level of gross negligence or a gross abuse of discretion, the business judgment rule should protect business

decisions from being second-guessed by courts. The business judgment rule is a central component of the proper defense of claims against directors and officers. Good corporate governance can protect officers and directors by promoting sound corporate decision making procedures and ensuring the availability of the business judgment rule.

II. Manage Your D&O Claims

Manage the D&O claims process by: (1) appreciating how your D&O liability insurance company will respond; and (2) avoiding the potential pitfalls of disqualification of your counsel.

A. How Will My D&O Liability Company Respond?

When a D&O claim is submitted, the insurance company typically will issue a reservation of rights letter which raises all possible defenses to coverage. Such letters are often long, strongly termed statements advancing the insurance company's position as to why insurance coverage may be denied or substantially reduced. They usually recite facts which the policyholder presented when the claim was filed. These letters often quote extensively from the policy and list the insurance policy exclusions that the insurance com-

pany contends are potentially applicable to the claim. The insurance company also will argue that some or all of the liability alleged in the underlying claim is attributable to: (1) uncovered claims; or (2) the conduct of uncovered parties. When the underlying claim is resolved and presented to the D&O insurance company for payment, the insurance company may also contend that: (1) the defense costs were excessive; or (2) the case was not properly litigated.

Claims against officers and directors often include allegations of fraud or self-dealing. Insurance companies may argue that, to the extent that the directors and officers were acting with a selfish or fraudulent intent, any resulting liability is within an exclusion. Sometimes insurance companies use allegations of a director's or officer's intentional misconduct to attempt deny insurance coverage in its entirety, even if minimal information exists to support such allegations. Insurance companies sometimes use this tactic even when other allegations contained in the very same lawsuit bring the policyholder's claim within the scope of coverage.

B. Avoid Giving Your Insurance Company Extra Leverage

While in the midst of a complex D&O claim, your insurance company may improperly attempt to disqualify of your defense counsel with regard to insurance coverage issues. In many states, rules of professional conduct prohibit a lawyer from acting as an advocate in a trial where the lawyer or another lawyer in

the same firm is likely to be a necessary witness.

If there is a dispute regarding insurance coverage and the defense of the D&O claim, the insurance company may argue that the counsel defending the underlying claim is a necessary witness regarding the claim against the insurance company. The Result: New insurance coverage trial counsel for the policyholder on the eve of trial!

Defense attorneys who defend D&O claims often have special relationships with D&O liability insurance companies. Certain D&O insurance companies in fact have "panel counsel" who are highly regarded attorneys for the defense of D&O claims. Such defense counsel may urge that their "special relationship" with the D&O insurance company is an advantage when resolving claims. Is it?

III. Good Corporate Governance Can Help

One relatively new and enlightened approach to the problem of D&O liability is good corporate governance. The key to good corporate governance principles is an independent board of directors. Indeed, a growing number of corporations have formed a Corporate Governance Committee of the board of directors. This ensures the selection of directors with independence and sufficient stature to challenge management appropriately.

The essential goal in a focused corporate governance approach is to protect the process by which a corporation reaches its decisions. Ensuring that the corporate

decision making process and the board's independence is protected is in the main just simply a good idea. See Gallagher, "The Activist Board and Corporate Governance," Fordham Fin. Sec. Tax Law Forum (Speech delivered March 13, 1997). Additional effects from such a process include: (1) a likely lessening of D&O claims generally; (2) a protection of the "business judgment rule" defense; and (3) a potential decrease in D&O liability insurance premiums based upon a good corporate governance structure. A good D&O liability insurance broker should be able, given the appropriate corporate governance initiative, to obtain appropriate consideration from your D&O liability insurance company.

Your directors and officers will sleep easier knowing that their potential liability exposures and insurance for those exposures is properly managed. The combination of appropriate liability insurance and good corporate governance may actually be a "match made in heaven."

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