

D&O Liability Insurance Basics

A recent headline screamed "D&O Insurance Prices Up More Than 30% in 2003." Given this enormous level of increase and the "I'd rather fight than pay" claims-handling philosophy of many D&O liability insurance companies, an insurance consumer needs an education in D&O Liability insurance. Indeed, some policyholders have discovered that they also need an insurance coverage litigation education in order to get their D&O insurance company to provide value for their insurance dollar.

Standard Policy Language

Under a D&O insurance policy, the insurance company promises to indemnify, or pay on behalf of, the directors or officers all "Loss" that those individuals become legally obligated to pay for a "Wrongful Act" committed in their capacity as an officer and director. "Loss" is defined in the policies and generally includes any amounts paid in judgment or settlement, as well as the costs of defense. "Wrongful Act" generally is defined to include any negligent act, error or omission, or breach of duty committed by the directors or officers in the discharge of their duties and solely in their capacity as directors and officers. This promise, referred to as Coverage A, operates in favor of individual directors and officers.

Under Coverage B, the insurance company agrees to reimburse the corporate policyholder for all Loss that the company is required to indemnify, or has legally indemnified, the directors or officers for a claim alleging a Wrongful Act. Coverage B does not insure claims brought directly against the corporation.



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Entity Coverage – Coverage "C"

Previously, D&O policies in the United States also usually included limited "Entity Coverage." A recent study of the U.S. market stated that over 90 percent of U.S. policyholders reported their D&O insurance included entity coverage, either by endorsement or as a part of the newer policy forms.

Under such a policy, the insurance company agrees to reimburse the corporate policyholder for liability arising out of certain types of claims made against the corporation, such as claims brought by investors under the securities laws, or for employee liabilities. However, Entity Coverage may reduce the limits available to protect the individual officers and directors. AIG itself has even suggested that D&O policies should not contain entity coverage, because of, among other things, complications in any potential bankruptcy process. "D&O Policies Should Not Cover Entities: AIG," *Business Insurance*, September 16, 2002, at 2, col. 5. Is this the same AIG which promoted and sold this newfangled coverage?

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.

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 company contends are potentially applicable to the claim. Frequently, such letters also include a clause--or more appropriately, a trap--binding

the policyholder to the insurance company's claims handling methods and arguments. Typically, after laying out the grounds for the potential denial of insurance coverage, the ROR letter provides the following:

Unless the insurance company receives written notice to the contrary within ten days of this letter, the insurance company shall assume that the policyholder agrees to its handling of this matter with a full reservation of rights, and the insurance company shall proceed accordingly.

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. In other words, your D&O insurance company adopts the positions of the underlying claimant and attempts to make its case against the policyholder. The result is that a policyholder has an additional adversary — your own D&O liability insurance company. You may need to prepare for an additional dispute.

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 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 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! Since D&O claims often take years to develop, the policyholder is left with the possibility of brand-new trial counsel days or weeks before trial.

Defense attorneys who defend D&O claims often have 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. Given the strategic and tactical cross-currents, should the underlying D&O defense counsel pursue the potential D&O liability insurance fight?

Conclusion

Understanding the policy you buy, and managing the claims process (or, if need be, the litigation process) can help ensure that you receive full value for your insurance dollar. The D&O area has seen such enormous price increases that getting value from your insurance policy is something you should expect, and value for which you must be willing to fight.

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