

Special Advertising Section

OUTSIDE PERSPECTIVES

Five Practical Tips For Maximizing Your D&O Insurance Coverage In The Wake Of The Great Recession

THE ECONOMIC TURMOIL AND corporate dislocation of the last two years underscore the need for directors and officers to take appropriate steps to maximize their directors and officers (D&O) liability insurance. In the wake

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of the collapse of the U.S. credit market, directors and

officers will continue to face an increase in bankruptcy litigation, shareholder claims, securities class actions, regulatory investigations and suits, and even criminal investigations and prosecutions. Complicating matters further, the economic crisis has resulted in a “soft” D&O market characterized by lower premiums, and consequently, stricter claims review and an increase in coverage denials by insurance companies. Even if your company has emerged relatively unharmed from the economic crisis of the “Great Recession,” your directors and officers will want a world-class D&O insurance program that will see them through the worst-case scenario. Set forth below are five practical tips for getting the most out of your D&O liability insurance.

1. Think D&O

When faced with a suit threatening substantial liability and legal expense,

directors and officers should look to D&O insurance. Most D&O policies broadly insure against losses arising out of “wrongful acts” committed by a corporation, its directors and officers, and other high-ranking employees. Typically, D&O policies broadly define “wrongful acts” as “any act, error, misstatement or omissions, neglect or breach of duty” committed by the directors or officers while serving in that capacity. Moreover, D&O insurance policies function as “litigation insurance,” in that they advance legal fees and costs for defending claims against directors and officers. For these reasons, an effective D&O insurance program is a crucial component to effective risk management in the face of increased scrutiny from courts, shareholders, and government regulators.

2. Manage the D&O Claims Process

Manage the D&O claims process by understanding how your D&O liability insurance company will respond to a claim. When a D&O claim is submitted, the insurance company typically will issue a reservation of rights letter that raises all possible defenses to coverage. Such letters are often long, strongly-termed statements arguing the insurance company’s

position that coverage may be denied or substantially reduced. These letters often quote extensively from the policy and list insurance policy exclusions that the insurance company contends are potentially applicable to the claim. Such assertions often have little basis in fact and are recited in an improper attempt to protect the financial self-interest of the insurance company.

3. Do Not Accept Coverage Denials

Policyholders should be prepared to resist the purported, often overblown, defenses asserted in an insurance company’s reservation of rights letter. Below are some examples of coverage defenses that insurance companies often assert inappropriately.

The “Insured vs. Insured” Exclusion. The so-called “insured vs. insured” exclusion, which is commonly found in D&O insurance policies, often purports to preclude D&O coverage for claims by an insured against another, though there are many forms of this exclusion. The exclusion originated in the early 1980s in response to collusive attempts to obtain D&O coverage for losses resulting from the acts of insureds. Thus, the exclusion is widely interpreted to prevent only collusive lawsuits by a corporation against its officials.

Policyholders should be aware of two instances where insurance companies have asserted this exclusion:

First, insurance companies improperly have argued that the exclusion precludes coverage when a regulatory agency or statutory receiver, such as the FDIC, sues a former director or officer. However, most courts have held that the exclusion does not apply in these situations because the exclusion is designed and intended to prevent collusive lawsuits between “insureds.” Regulatory agencies and receivers are sufficiently adverse parties to a corporation and its officials, not “insureds,” and thus, lawsuits brought by them against directors and officers cannot be collusive in nature.

Second, insurance companies improperly have asserted that the “insured vs. insured” exclusion precludes coverage for claims brought by a bankruptcy trustee or a creditors’ committee against directors and officers on behalf of the corporation. According to a the Administrative Office for the U.S. Courts, business bankruptcy filings remained high in the year ending March 31, 2010, totaling 61,148 compared to 49,091 in the year prior. Given the risks of these arguments, one approach might be an exception (or a “carve-out”) to the “insured vs. insured” exclusion for suits brought by a bankruptcy trustee or creditor.

Regulatory Exclusions. The “regulatory” exclusion purports to deny coverage for suits brought by any governmental, quasi-governmental, or self-regulatory agency. These exclusions proliferated in the wake of the Savings and Loan Crisis of the 1980s and were often found in D&O policies issued to financial institutions. According to a 1995 estimate, 50 to 75% of D&O policies sold to banks contained regulatory exclusions. In recent years they have become much rarer as the D&O market softened and memory of the prior crisis faded. However, with the number of failed financial institutions rising daily, policyholders should expect a

resurgence of the regulatory exclusion and be prepared to defend against it.

If your policy does contain this exclusion, closely examine its wording. In some cases, the policy will name specific regulatory agencies; in others, not. While some courts have upheld the applicability of regulatory exclusions, others have determined the language to be ambiguous and refused to preclude coverage. Moreover, in cases in the wake of the S&L crisis, government regulators themselves successfully defended against the regulatory exclusion as against the public policy supporting the ability of federal regulators to sue directors and officers that have committed wrongful acts.

Bad Acts Exclusion. Almost all D&O policies include exclusions that purport to deny coverage for liability arising from fraud, criminal acts, or intentional misconduct. Claims against directors and officers often include allegations of fraud and self-dealing, and insurance companies sometimes improperly argue that, to the extent that the directors and officers were acting with a selfish or fraudulent intent, any resulting liability falls under this exclusion. Policyholders should keep in mind that the law is clear: These exclusions apply only after a final adjudication of claims, and directors and officers are entitled to an advancement of legal costs to defend against any allegation of intentional misconduct or fraud.

4. Give Notice Early and Often

If there is any possibility of a claim under your D&O policy, consider giving notice now. Give notice through the insurance broker to all potentially applicable insurance policies. Pay close attention to any and all notice provisions contained in your insurance policies and comply with them. Insurance companies routinely deny insurance coverage by arguing that the policyholder did not furnish timely notice. *Do not let them.* While examining the nature

of your claims and your liability insurance policies is necessary, do not permit such review to delay notice.

5. Continue to Protect D&O Insurance

When confronted with liabilities arising out of the current financial crisis, continuing efforts to protect the availability of liability insurance are crucial. In-house counsel and risk management personnel can provide valuable counsel in interpreting existing insurance policy exclusions and resolving insurance disputes. Moreover, risk management teams should pay close attention to D&O policy language when renewing policies from year to year. As new trends in the D&O market emerge, policyholders should seek to improve the scope of their D&O policies and avoid ambiguities. Take steps today to protect your D&O Insurance. These five tips are a few pointers for protecting your D&O liability insurance in the wake of the Great Recession.

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