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10 Traps in Your D&O Insurance

By William G. Passannante and Joshua Gold

D&O Insurance Policy Improvements & Claims Strategies

D&O insurance typically provides broad coverage for alleged "wrongful acts." Despite this breadth of coverage, disputes are not uncommon — especially where the claims are large. When buying or renewing D&O insurance coverage, it is important to work with an experienced risk manager or insurance broker who can focus not only on price, limits and structure, but on the fine print too. Below are 10 areas that can be enhanced in your D&O policies and management of claims to head off improper coverage defenses.

1. Notice Terms

The notice terms of D&O insurance policies can be made specific to a particular set of individuals within a corporation or organization. A notice condition that is tied to any "Insured" can lead to an inappropriate argument from your D&O insurance company given that the term "Insured" means any past, present or future officer or director. To deny coverage improperly on late notice grounds, insurance companies may seek to investigate what everyone "knew" and "when" they knew it. A notice clause tied to the knowledge of the head of risk management or the chief legal officer of the law department is less subject to such abuse. Ask your broker if it is available.

2. "Professional Services" Clauses

Professional services clauses are often a locus of ambiguity in D&O insurance policies — especially those sold to the financial services industry. A D&O insurance company will often contend that a claim is intended to be covered by an errors and omissions insurance policy as a "malpractice" claim rather than a D&O claim. These exclusions are often improperly invoked in two ways:

1. the insurance company interprets the professional services exclusion in an unduly broad manner, and

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William G. Passannante is a shareholder in the New York office of Anderson Kill. Mr. Passannante is co-chair of the firm's Insurance Recovery Group and is a leading lawyer for policyholders in the area of insurance coverage. He has appeared in cases throughout the country and has represented policyholders in litigation and trial in major precedent-setting cases.
(212) 278-1328 | wpassannante@andersonkill.com

Joshua Gold is a shareholder in the New York office of Anderson Kill and chair of the firm's Cyber Insurance Recovery Group. Mr. Gold's practice involves matters ranging from international arbitration, data security, directors' and officers' insurance, business income/property insurance, commercial crime insurance, and insurance captives. He has been lead trial counsel in multiparty bench and jury trials, and has negotiated and crafted scores of settlement agreements including coverage-in-place agreements.
(212) 278-1886 | jgold@andersonkill.com

2. many underlying claims filed against policyholders are ambiguously pled regarding managerial decisions, or the services provided.

For example, a claimant may assert that it lost money when the policyholder sold it securities that senior management allegedly were pressuring its sales force to market to customers. Such an allegation could trigger both D&O and E&O insurance coverage. However, if you have purchased these policies from two different insurance companies, each may incorrectly point the finger at the other and improperly attempt to disclaim insurance coverage.

If the insurance company insists on inserting a professional services exclusion into the D&O policy, policyholders should push for the narrowest version available on the market, one that will not strongly support improper arguments at claims time.

3. "Wrongful Acts"

The term "wrongful act" is central to virtually any insuring agreement section of a D&O or E&O policy. Make sure that your policies use standard and broad definitions of this term, which defines the scope of coverage.

Allegations of intentional misconduct, including fraud, routinely are covered. It is not uncommon to see allegations of negligence on the one hand, and fraud on the other, positioned right next to one another in a complaint against the policyholder. Your risk manager or broker can make sure to avoid a nonstandard definition that might permit arguments attempting wrongfully to negate coverage.

4. Claim Timing Exclusions

D&O policies are intended to provide "continuity." Work with your risk manager or broker to push back in time certain claim date provisions. For example, your policy may have a "retroactive date" or a "prior and pending litigation" date. Such dates can lead to improper insurance company arguments based on vague references to conduct undertaken, products sold or services performed many years ago. Setting the "retro" date or similar date in the policy as early as possible can avoid such attempts to evade coverage.

5. Exhaustion of Towers

Excess insurance companies often improperly deny coverage on grounds that the underlying coverage was not "exhausted" when the policyholder accepts less than full payment from the underlying insurance company and makes up the difference with its own money. Unfortunately, these improper arguments have been accepted by some courts.

You can protect yourself against exhaustion defenses by ensuring that each excess insurance policy purchased contains explicit language affirming that the policyholder can use its own money to bridge the "gap" any time an underlying insurance company does not pay its policy limits in full.

6. Breach of Contract Exclusions

Because litigation is often initiated by a party with whom the policyholder has a contractual relationship, breach of contract exclusions should be avoided. Many standard forms contain an express carve-out to the exclusion for liability that would exist in the absence of a contract, consistent with underwriting intent.

7. D&O Coverage for Cyber Claims

Last year, any lingering doubts about the necessity of D&O insurance coverage for cyber-related claims were erased when derivative claims were brought on the heels of some highly publicized data breaches of public companies. We have helped policyholders secure so-called D&O entity insurance coverage for cyber-related claims. D&O insurance coverage will continue to be an important source of cyber claim protection for directors and officers going forward — especially as federal and state regulators are placing more and more of the onus on senior executives to address cyber perils. Cyber exclusions have no place on D&O insurance policies.

8. "Large Law" Conflicts Issues in D&O Claims

Large law firms that serve as defense counsel often seek to avoid disputes with large insurance companies. In ordinary cases with no coverage issues in dispute, this predisposition causes little difficulty and the defense goes smoothly. Where a dispute over coverage arises, however, the

inability of defense counsel to prosecute the coverage dispute presents a problem. Independent policyholder coverage counsel, attuned to the interest of the defense, can be an effective solution.

9. Foster Good Communication With the Insurance Company

Good communication with both claims and underwriting can help avoid misunderstandings. Under the guise of "cooperation," insurance companies have recently begun dangerous efforts to interfere with the defense of claims — often without sufficient protection for the policyholder's attorney-client privilege. This effort is often a ruse undertaken to generate a coverage defense. Experienced risk management personnel and coverage counsel know how to nip such interference in the bud.

10. Fundamental Purpose of D&O Insurance

One formulation of the fundamental purpose of D&O insurance is to protect the personal assets of the board members so the corporation can attract the best board of directors possible. Work with your risk manager, outside insurance consultant or broker to determine the purpose for your corporation's purchase of D&O insurance, and structure the insurance policy consistent with that purpose. For example, for the protection of senior executives in the event of a large stock-drop case, is it better to have EPLI coverage separate from D&O coverage so that the limits are used by non-D&O claims? Understanding the purpose in buying D&O insurance will guide the specifics of your purchase.

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