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Tips For Executives To Maximize D&O Coverage

By **Jeff Sistrunk**

Law360, Los Angeles (June 27, 2016, 2:58 PM ET) -- With federal and state regulators ramping up enforcement efforts, corporate executives and boards of directors are facing more potential sources of liability than ever before, such as claims that they misled investors about securities offerings or misstated a company's financial condition.

Here, Law360 offers tips to get the most out of directors and officers coverage.

Negotiate Adequate Limits

The top priority for a corporation seeking D&O insurance is to find a policy with adequate limits of liability to cover any claims that may be leveled against the directors and officers of the firm, so it can avoid reaching into its own coffers to fund defense or settlement costs associated with litigation or government probes, attorneys say.

"It is important to make sure the insurance provides sufficient limits of liability, given the size and risk profile of the company," said Brian Mukherjee, counsel in Goodwin Procter LLP's litigation department.

A common way for a company to decipher appropriate D&O limits is through the "benchmarking" process, where an insurance broker looks at the insurance limits and other related data of peer companies and compares that information to what the company in question may consider purchasing or currently holds, Mukherjee said.

However, attorneys say that a company should take further steps to try to quantify its potential exposures, such as analyzing publicly available data on settlements of securities and other litigation, which can provide insight into the amount of money it may take to resolve a given type of lawsuit.

"[Benchmarking is] not the end-all of the analysis, but it is an important data point for the board to consider," Mukherjee said.

Secure 'Side A' Coverage

To secure maximum protection, corporate boards and executives should ensure their company's D&O policy provides so-called Side A coverage, which directly covers directors' defense and settlement costs in situations where the company is unwilling or unable to indemnify them, according to attorneys.

Unlike Side B coverage, which covers a company's costs to indemnify its directors and officers, and Side C coverage, which covers both the company and its board and executives against certain types of claims, Side A coverage isn't subject to any deductibles or self-insured retentions.

"The benefit of course is that a director or officer can use that coverage without having a retention apply," said Carolyn Rosenberg, a partner in Reed Smith LLP's insurance recovery group. "What's important is, if there is any dispute as to whether or not a company is going to indemnify a director or officer, the director or officer can have the policy kick in and any defense costs covered from dollar one."

In addition, in the event a company hits bankruptcy, the proceeds of Side A D&O coverage aren't treated as property of the estate, so directors and officers can continue to rely on the coverage to defend themselves against claims during the pendency of the bankruptcy proceeding, attorneys say.

"Because Side A insurance is not considered property of the estate in the event of a bankruptcy proceeding, and therefore 'bankruptcy remote,' it could be the only lifeline available to directors and officers in bankruptcy," Mukherjee said.

Get a Broad Definition of 'Claim'

With the uptick in shareholder class actions and enforcement efforts by the U.S. Securities and Exchange Commission and other regulators, it is important for a company's D&O policy to contain a broad definition of a "claim" so that no potential source of exposure slips through the cracks, attorneys say.

For example, coverage may not exist under a D&O policy for an informal government inquiry, such as a subpoena sent to a corporate officer seeking information about a particular business practice. But a company may be able to secure coverage for the costs associated with those sorts of inquiries if it negotiates a broader definition of a claim.

"Given the ever-changing regulatory landscape, directors and officers are getting involved in matters earlier and earlier and in a wider range of situations than before," said Hunton & Williams LLP partner Syed Ahmad. "The definition of 'claim' should cover as many of these potential scenarios as possible."

However, attorneys note that boards and executives should be aware that with a broader claim definition, they will also be expected to report anything that may constitute a claim to the insurance company in a timely fashion, to avoid being denied coverage on account of late notice.

"Even a nasty email could in certain circumstances constitute a 'claim,'" Mukherjee said. "It's crucial that any claim received is timely reported to the carrier."

Narrow the Exclusions

D&O policies commonly contain several exclusions that can potentially cause trouble for companies if their language isn't limited.

One such exclusion, known as the "insured v. insured" exclusion, generally bars coverage for claims asserted by or on behalf of the insured corporation or its directors or officers against other parties insured under the D&O policy. As such, a company targeted in a whistleblower suit or employment discrimination complaint brought by a current or former officer could find itself without coverage unless exceptions are built into the insured v. insured exclusion, attorneys say.

"Seek to carve out from the exclusion employment claims, bankruptcy proceedings and whistleblower claims," Ahmad said.

Another common D&O exclusion bars coverage for claims resulting from fraud or other misconduct on the part of an executive or board member. Companies should seek to limit that exclusion by tailoring the language so that it will apply only if a director's or officer's misconduct is firmly established by a court in a final, nonappealable judgment, attorneys say.

Furthermore, companies should ensure that a D&O policy's misconduct exclusion is severable, so that the bad acts of one insured director or officer won't erase coverage for other innocent insureds, according to experts.

In a similar fashion, a company can ask the insurance carrier to include a "severability of the application" provision in its D&O policy, which will preserve coverage for innocent insureds if one insured made misrepresentations on the policy application, attorneys say.

Control the Defense

Corporate policyholders can take steps when applying for a D&O policy to ensure that they have maximum control over the defense of future claims.

If a corporation buying D&O coverage has a preferred firm that it generally uses as defense counsel, it can obtain the insurer's approval of that firm during the application process, said Anderson Kill PC shareholder Bill Passannante. Getting preapproval for a particular firm can help a company avoid disputes with a carrier over choice of counsel down the road, according to attorneys.

"If Company X knows it wants to use particular defense counsel, getting approval of the firm and rates is easier to do up front," Passannante said.

Of course, corporations and their directors and officers should still keep their D&O insurers abreast of major developments in the status of each claim, according to attorneys.

"When it is time to settle or mediate a claim, you'll want to make sure the carrier is already up to speed on the claim and ready to participate," Mukherjee said.

--Editing by Katherine Rautenberg and Edrienne Su.
