

Enron, Worldcom

How To Make D&O Liability Insurance Work For You

By William G. Passannante

A number of recent developments have made the purchase of D&O liability insurance even more difficult. First, more than ever before, D&O liability insurance companies will challenge demands for coverage related to large losses. Second, "entity coverage," which has become wildly popular in the United States, has a dark side for Directors and Officers. Third, one potential solution promoted by various groups, "Financial Statement Insurance," is a good idea which will not work. Finally, difficult times like these make the claims-handling philosophy of your D&O liability insurance company, a difficult quality to evaluate, even more important.

D&O Insurance Companies Fight Rather Than Pay

Recently, revelations of accounting irregularities reportedly inflated WorldCom, Inc.'s assets by almost \$4 billion dollars. WorldCom reportedly maintained \$100 million in D&O liability insurance coverage, written by five insurance companies. Reports have indicated that the D&O liability insurance coverage likely will be challenged by the insurance companies. The insurance companies are anticipated to attempt to rescind the insurance policies which they sold to WorldCom. The purported basis for such an attempt likely would be fraud or intentional misrepresentation on the part of WorldCom. For a director or officer who expects D&O insurance to protect her in a time of need, such a scenario is a nightmare.

Regarding the current state of the D&O insurance market, one report noted, "Everything that could have gone wrong has gone wrong."

Entity Coverage Is Not Working

So-called "entity coverage," explicitly added to many insurance policies in recent years, has become very popular. According to the most recent Tillinghast-Towers Perrin survey results, more than 90% of U.S. policyholders purchased entity coverage during 2001. This number is up from less than 30% five years ago. Nonetheless, a recent "white paper" by one of the largest D&O insurance companies in the world notes that entity coverage has had unintended harmful effects to the coverage for Directors and Officers.

If the principal reason for the purchase of D&O liability insurance is protecting the personal assets of directors and officers, there may be reasons to avoid diluting the protection of Directors and Officers with coverage provided to the corporate entity.

Financial Statement Insurance Is No Answer

A number of commentators have raised a potential solution to the massive accounting scandals facing so many public corporations. One proposal is that

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For more information on these or other executive insurance matters, please contact one of the lawyers listed, each of whom practice in the area.

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corporations buy "financial-statement insurance," policed by insurance company-appointed auditors.

While this idea may have facial appeal, especially to insurance companies eager to collect premiums and avoid paying claims, it simply will not work. Corporate managers currently have insurance products, such as D&O liability insurance and Errors and Omissions liability insurance, available to cover similar types of exposures. The insurance companies which already sell such insurance currently have a very strong incentive to make sure that financial misstatements do not take place.

Your D&O Liability Insurance Company's Claims Handling Philosophy

As the market for D&O liability insurance has tightened, policyholders have been met with massive premium increases and gambits by D&O insurance companies to narrow coverage.

A few insurance companies dominate most of the D&O marketplace; however, a large number of insurance companies have at least offered this product. For the past decade, this has meant that some policyholders could at least find D&O insurance policies at competitive rates. The current turmoil in the insurance and stock markets, as well as the after-effects of Enron, WorldCom and September 11 — as well as opportunism — have all contributed to increases in D&O liability insurance premiums.

This makes the claims handling philosophy of your D&O liability insurance company even more important.

What To Do Now

Purchasers of D&O liability insurance need to keep several principles in mind: (1) purchase insurance from an insurance company with a favorable claims-handling philosophy. An experienced D&O insurance broker is the best way to avoid surprises in this area. (2) Avoid being a "test case" for new expensive types of insurance coverage. Entity coverage is not a panacea, nor is financial statement insurance. (3) Finally, when you have a significant claim do not take "No" for an answer. Insurance companies routinely contest significant claims. Don't fall for it. ■

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