

ALERT

## D&O Liability Insurance and Sarbanes-Oxley—On a Collision Course?

By William G. Passannante

There has been a massive change in the nature of liability for corporate directors and officers in the wake of Enron, WorldCom and other similar events. Corporate directors and officers are rightly concerned that their liability insurance coverage has not kept up with this changing liability landscape.

The Sarbanes-Oxley Act of 2002 (HR 3763) creates rules regarding corporate responsibility, enhanced financial disclosure, corporate and criminal fraud accountability, public company accounting quality control standards and auditor independence, and rules of professional responsibility for attorneys. The CEO or CFO will be required to personally certify financial reports. The audit committee will be directly responsible to oversee outside auditors.

The Act also requires enhanced financial disclosures of off-balance sheet transactions and pro forma financial figures. The Act will modify the relationship between a public company and its outside auditors, and management will face greater scrutiny of its conduct. Acts and events covered under directors and officers liability insurance policies may face greater scrutiny on account of the Sarbanes-Oxley Act.

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### *Changes in D&O Liability Insurance Coverage*

Sarbanes-Oxley and the recent spate of bankruptcies of major public corporations is fueling change in the D&O marketplace. Recently, one of the market-share leaders in selling directors and officers liability insurance, The American International Group (“AIG”) announced changes in the availability in “entity” coverage under D&O liability insurance policies. Such corporate entity coverage will not appear in some basic policy forms in the future.

Further, another market-share leader in selling directors and officers liability insurance has announced new products specifically directed at the “personal” liability of directors. Chubb’s advertisement for its new Personal Directors’ Liability Insurance states, “That board you’re sitting on? The Company’s going down the tubes. Will your personal assets go down with it?”

AIG also sells a new independent directors and officers liability insurance product which it calls “IDL Premier.” AIG advertises IDL Premier as “the first insurance product available to specifically protect independent directors.” Indeed the advertisement for this new product states, “Independent directors face new risks. Changes in SEC regulations. New Corporate governance legislation. More lawsuits and higher jury awards. These days, if your company restates financials or files for bankruptcy your current D&O policy may not protect you.”

The market-share leaders in directors and officers liability insurance seem to have identified a market that for a new insurance product. Just how much of this insurance already should be available under current standard directors and offi-

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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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cers liability insurance policies will be subject to vigorous debate. Nonetheless, the current atmosphere regarding director liability has created a dynamic marketplace for the sale of these policies.

### *Sarbanes-Oxley Prohibits Many Loans to Directors and Officers*

Public companies subject to Sarbanes-Oxley may not make certain loans to directors and officers. Precisely what constitutes a loan to a director or officers has not been litigated in the context of D&O insurance. D&O insurance policies may provide for the advancement of defense costs in certain instances. Further the corporation may be permitted to or required to advance defense costs to defend a director or officer. The advancement of defense costs under the "anti-loan" provisions of Sarbanes-Oxley is an issue to watch.

### *Bankruptcy Impacts D&O Liability Insurance*

The major bankruptcies of public companies have had a significant impact on directors and officers liability insurance. One issue which repeatedly has been litigated is whether the proceeds of a D&O liability insurance policy are an asset of the bankruptcy estate or an asset of the individual directors and officers. Indeed, the fairly recent addition of "entity" coverage to D&O liability insurance policies gave additional weight to the notion that the proceeds of such policies might be included in the assets of the bankruptcy estate. Indeed, it is possible that such arguments are one reason why a number of insurance companies have removed "entity" coverage from their standard form D&O insurance policy. Given that various insurance companies use differing forms, and that those forms are in a rapid state of change, close attention to the details of your D&O liability insurance policy is crucial.

The premium increases for many policyholders have been startling. The ability of many policyholders to retain broad coverage provisions has been diminished in many industries. Given the massive changes and the nature of liability for corporate directors and officers extra care must be paid to directors and officers liability insurance issues both at underwriting and claims time. D&O expert broker and other insurance professionals experienced in the D&O area may help avoid unpleasant surprises. ■

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