AKO EXECUTIVE INSURANCE ALERT

ANDERSON KILL & OLICK, P.C.
Attorneys and Counsellors at Law

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Directors and Officers Liability: Avoid Catastrophe—Think Insurance Coverage

by Eugene R. Anderson and John G. Nevius

When catastrophe strikes—a lawsuit is brought against you or other directors and officers of your organization—consider the potential insurance coverage available under a directors and officers (D&O) liability insurance policy.

When the lawsuit is filed, D&O claim handlers know that they probably can count on leading policyholder lambs to the slaughter. A D&O insurance company executive has written that policyholders' general counsel are "usually not trained to understand insurance, especially not D&O insurance." The same inexperience may characterize the outside counsel defending the lawsuit. Insurance companies know exactly what they are doing.

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The Long Road

It can take years to resolve these lawsuits. It may take longer to resolve the resulting insurance claim. All too often, steps taken early in the underlying lawsuit subsequently will be used against a policyholder while the claim is pending.

Policyholders need to hit the ground running in the right directions; toward the best possible defense as well as toward insurance coverage. A misstep today can destroy coverage tomorrow and lead to another catastrophe.

Chronology

Year One: Insurance Acquisition – When a loss happens, the insurance company is going to scrutinize the policyholder and each of its directors and officers as well as the easy-to-answer application they submitted when purchasing a D&O insurance policy.

Year Two: The First Catastrophe – The directors and officers are sued following a significant drop in the corporation's market value. Insurance company D&O claims handlers have testified that purchasing or increasing D&O coverage raises a "red flag;" i.e., why buy the insurance if you did not think you would need it? This underlying philosophy leads claims handlers immediately to begin developing facts to support coverage denial.

Give Notice — Give Notice

When a D&O claim is threatened, failing immediately to send notice to the

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insurance company is another misstep. Notice is usually, and probably best given by brokers, not existing counsel, who often are not fully prepared to provide coverage advice and may have "positional conflicts." Lawyers who give notice are labeling themselves as amateurs and may be called as witnesses. The risk manager and broker should be key players at all stages of the claim process. Litigation takes time and insurance companies use the passage of time to their advantage.

Reservations of Rights Letters

Insurance companies routinely respond to claims with a long, legalistic and threatening reservation of rights ("ROR") letter that often contains inapplicable defenses and exclusions as to why coverage is unavailable. This letter is the first indication that the insurance company is hard at work looking for ways to deny coverage and generally sets the boundaries for any ensuing coverage dispute. A policyholder must reserve its rights with a response that copies those being sued.

Monthly Status Reports

During the entire case, defense counsel should send monthly status reports and copies of bills showing all defense costs, including internal corporate legal expenses, but excluding all time and expenses related to coverage matters. If possible, bring the insurance company into the settlement discussions so that any dispute(s) can be resolved as part of the underlying settlement. Failure to do so may reduce or void the payment of some defense costs.

The Second Catastrophe

Years Three-Ten – The policyholder's legal team vigorously defends the underlying lawsuit. In Year Five, settlement negotiations with the class action lawyers begin. After coverage is denied, substantial legal fees may be necessary to prosecute a coverage lawsuit until the case is ready for trial and settlement discussions begin in earnest.

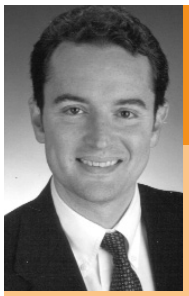
The Third and Penultimate Catastrophes

The insurance company either threatens to call the policyholder's outside counsel as a witness and new counsel must be obtained on the eve of trial, or threatens to commence a subrogation action against outside counsel and accountants for malpractice. In resolving these potential catastrophes, the policyholder may be left further behind in obtaining coverage.

The Final Catastrophe

The policyholder renews coverage and the cycle begins anew. D&O claims and coverage controversies are litigated over many years. Policyholders must be aware that steps taken early on may jeopardize coverage recovery years into the future. Learning the basic rules to the insurance coverage "shell game" will help ensure that when faced with a D&O claim, coverage is available. ■

The information appearing in this newsletter does not constitute legal advice or opinion. Such advice and opinion are provided by the Firm only upon engagement with respect to specific factual situations.



who's who

John G. Nevius is a member of the Executive Insurance Industry Group. Mr. Nevius successfully has litigated numerous insurance coverage actions on behalf of policyholders and provides advice and technical expertise on a wide range of environmental matters. Mr. Nevius also is a registered Professional Engineer.

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We hope you have found this issue of the Executive Insurance Alert informative. We invite you to contact the Editor, William G. Passannante at (212) 278-1328 or wpassannante@andersonkill.com with your questions and/or concerns.

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