

# Directors and Officers Liability Insurance

## What Every Corporation Needs to Know

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### Little Known Facts About Directors and Officers Liability Insurance

1. Most directors and officers liability insurance (“D&O insurance”) policies do not cover the costs, including attorneys’ fees, of responding to government investigations.

2. Most D&O insurance policies do not pay for the costs, including attorneys’ fees, incurred in responding to government subpoenas.

3. Nearly all D&O policies are “wasting policies,” that is, defense costs reduce the amount of coverage. Large claims can cost millions of dollars to defend—monies which will not be available to satisfy the judgment or settlement.

4. D&O insurance policies have a shared limit. Accordingly, multiple insureds with multiple attorneys may reduce limits quickly. Simply, the more insureds there are under the policy, the more people there are asserting a right to the policy limits for defense and indemnity.

5. If the D&O insurance policy provides entity coverage for the company, and the company files bankruptcy, the bankruptcy trustee may treat the policy as an asset of the bankrupt estate. This may, in effect, limit the coverage to the individual directors and officers.

6. If the application for D&O insurance contains material information that is false, the insurer may be able to rescind coverage under the policy for all insureds, including those who had no knowledge of the misrepresentation or the facts that were not properly disclosed.

7. Some D&O insurance policies provide that the insurer may rescind the policy based on false information outside the application, for example, SEC filings or press releases.

8. D&O insurance policies may not cover securities claims where the remedy sought is disgorgement, i.e., return of ill-gotten gains.

9. The D&O insurance policy may not provide coverage for claims by a bankruptcy trustee against the officer and directors of the bankrupt corporation.

10. Some D&O policies provide that where an insured does not agree to a settlement by a third party proposed by the insurer, then the insurer’s liability will not exceed the amount of the proposed settlement. This is often referred

to as the “hammer” clause because of the power it gives to the insurer to force a settlement.

11. Some D&O insurance policies require that the officers and directors in the company use pre-approved panel counsel. That means that the company and its officer and directors may not be able to use the law firm which it normally uses.

12. The general counsel is not ordinarily fully covered under a D&O insurance policy.

It is apparent that many difficult issues are faced by the company when it enters the market to purchase or renew D&O liability insurance - issues that many companies do not normally consider. How is “claim” defined in the policy? Is the definition of “claim” broad enough to cover a securities investigation or an SEC subpoena? Is the definition of insured broad enough to cover the general counsel? Are there adequate limits? Should entity coverage be purchased? What kind of severability clause is in the policy—is the application deemed to be a separate application by each insured or is the knowledge of the person signing the application or the knowledge of certain designated officers imputed to all insureds such that that knowledge can be used to rescind the policy? Can the hammer clause be removed from the policy? Has the company’s favorite law firm been added to the list of approved panel counsel?

#### What does all of this mean?

In light of (a) the Sarbanes-Oxley Act, (b) cases such as Disney that appear to heighten a director’s duties, and (c) the publicity about substantial unreimbursed settlement payments by directors in the WorldCom and Enron cases, individual directors and officers are facing increased liability for their actions and service on a board. Given the uncertainties of the legal environment, corporations need to offer individuals protection for personal liability to coax them to serve as officers and directors. D&O insurance is one tool a corporation may use to offer protection to its directors and officers.

The ability to protect directors and officers by purchasing D&O insurance is affected by ongoing changes in the insurance market for these policies. Insurers faced with claims for tens of millions of dollars are more vigorously disputing coverage or seeking to rescind policies. The likelihood of a coverage dispute is reduced if the corporation understands its policy, and seeks to

address potential situations prior to policy issuance. Protection of officers and directors is more likely if the insurance policy is coordinated with other corporate governance documents which relate to director and officer liability. This article sets forth certain key principles and issues to assist the corporation in making the decisions needed to evaluate its insurance component of protection of directors and officers.

### What Is The Purpose of a D&O Policy: What, Who and How Much

In evaluating a company’s D&O Policy, it is crucial to understand what purposes the policy is to serve.

First, it must be determined “what” the policy is seeking to protect against. One purpose is to protect directors, officers and often the company itself from claims of economic injury brought by shareholders, former employees and others. The policies are generally written broadly to cover “wrongful acts.” What constitutes a “wrongful act” is different in each policy. The definition of “wrongful act” must be evaluated to see if it is consistent with the purpose of the policy.

Although “wrongful act” may be broadly defined, several exclusions are aimed at avoiding double coverage with other insurance policies. Some risks, such as those associated with fraud, are just not insurable. The D&O policy can fill a gap—it can also create one, if the company does not have a full insurance program. For example, some D&O policies cover employment practices claims—others exclude such claims.

Second, it must be determined “who” the policy is to protect. There are differing groups of people whom the policy may protect. These include (1) current outside directors (2) past outside directors (3) current inside directors (4) past inside directors (5) executive officers (6) non-executive officers and (7) general counsel. The company may seek to protect some or all of these groups of people. Moreover, the company itself can be an “insured.” Some policies even extend coverage to “employees.”

Depending on the decision of “who” to cover, careful attention must be paid to various portions of the policy, including primarily the definition of “insured” to make sure that the persons intended

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to be covered actually are covered. Problems may arise when non-officers serve on firm committees, such as retirement committees. This may be addressed by having committee members defined as “insureds.” Problems may arise where the company is a PLLC, which does not have “officers” or “directors” but rather has “members.” Further, whoever is an “insured” will only be an “insured” while acting in her “capacity” as a defined officer or director. This may create problems where people are acting in multiple ways, especially outside directors and general counsel.

Other potential problems may arise from who is an insured. Under some policy language, any one insured could defeat coverage for all insureds. Such traps may exist in the “fraud,” “dishonesty” and “insured versus insured” exclusions; the “notice” provision and whether all insureds are bound by the representation or knowledge of any one insured as to questions asked in the application. The company, therefore, needs to examine whether there is an exception for “innocent” insureds and how that term is defined.

The number of insureds under a policy will affect the amount of coverage available to all insureds, since generally there is one limit of liability which will be reduced by the defense and indemnity of all insureds.

Other issues may arise depending on “who” is an insured. If the company is an “insured” for its own liabilities, and enters bankruptcy, the bankruptcy trustee may treat the policy as an asset of the bankrupt estate. This may, in effect, eliminate coverage to the individual directors and officers. This is especially problematic for those officers and directors who may be defendants in a suit claiming they are responsible for causing the bankruptcy.

There also may be issues raised by corporate mergers and acquisitions, and whether continuous coverage is afforded for former directors and officers of those companies which cease to exist.

Accordingly, in addition to deciding “who” to protect, the company should consider purchasing separate policies for directors, officers and the company.

Lastly, the company must consider “how much” protection to buy. “How much” should be determined by various factors. Paramount, naturally, is “how much” a judgment against the directors, officers or company could be. For a publicly traded company, the “damages” may depend on the value of the stock. A judgment could be in the hundreds of millions—settlements are frequently in the tens of millions. Against this “exposure” must be weighed the risk of such large—and viable—claims. The WorldCom directors ended

up paying out of pocket, presumably, because there were inadequate limits of liability in the insurance policies.

Limits of liability are affected by several other factors. Nearly all D&O policies are “wasting” policies; that is, defense costs reduce the amount of coverage. Large claims can cost millions of dollars to defend—millions which will not be available to satisfy any judgment or settlement. The policy likely has a shared limit. Accordingly, multiple insureds with multiple attorneys may reduce limits quickly. Moreover, the more insureds under the policy, the more people asserting a right to the policy limits for defense and indemnity. Where there are inadequate limits, fights over “priority” of payments may arise. Companies must review the policy to see if there is a “priority of payment” clause, and, if not, consider whether to request or draft such a clause.

Also, different “insureds” may face different levels of liability. It may be possible to have separate and distinct limits of liability for insureds—e.g., outside directors have one limit and officers have another. While this may not be appropriate for all companies, it is an option which should be explored.

Finally, “how much” may be affected by the answer to “what” is covered. For example, employment practices claims will deplete the limit otherwise available for other director and officer claims. There may be a synergy, as news of a large adverse employment practices claim may lead to a stock drop and shareholder suits. Even absent such synergy, the risks are separate enough that they should have separate limits.

### **What is Normally Protected: A Brief Summary of Side A, B and C Coverages**

D&O policies generally have three different types of coverage. Typically, these are referred to as Side A, Side B and Side C. A company may select one, all or some combination of these options. The company must realize there is no such thing as a “standard” D&O Policy and each D&O insurer is free to develop its own forms which can vary substantially from one insurer to another. Therefore, the language of each D&O Policy must be reviewed with great care.

Side A coverage is for the personal liability of officers and directors when the corporation is unable to indemnify them, because of corporate insolvency or because either the corporation’s by-laws or applicable law preclude indemnity by the corporation. This is the coverage of most concern to directors and officers, because it pays for their personal responsibility for defense and satisfac-

tion of claims.

Side B coverage pays (either in advance or in arrears) the corporation for amounts it is required to pay to defend and/or indemnify its officers and directors. Policies that pay in arrears (“reimbursement policies”) may create a cash-flow problem for smaller corporations who do not have the financial wherewithal to pay for large defense fees, or even a settlement, and then wait for reimbursement by the insurer.

Side C coverage is also known as entity coverage. This coverage protects the corporation, itself, from liability. Entity coverage can either be very broad or limited to certain types of claims. In general, entity coverage applies to securities claims and, in some cases, employment claims made against the corporation.

Side A, B and C coverage typically extend to liability for a “wrongful act” which is a defined term. Some policies define “wrongful act” broadly to include any allegation of a breach of duty by a director or officer. Others may limit the definition. In either event, exclusions in the policy may apply.

Employment practices claims may be covered in the D&O policy, rather than in a stand-alone employment practices liability policy. Since such claims may be more common than large shareholder suits, the corporation should consider whether to have a separate employment practices policy with a separate limit. Otherwise, employment claims may reduce the D&O limit so that there is inadequate insurance for shareholder claims.

## **Current Critical Issues In Reviewing A D&O Policy**

### **Application Issues**

As insurers confront more and larger director and officer claims, insurers are paying more attention to the representations on the application for the policy. WorldCom’s D&O insurers, for example, sought to rescind their policies. Accordingly, information supplied in the underwriting process is critical. If the application contains material information that is false, the insurer may attempt to rescind coverage under the policy for all insureds including those who had no knowledge of the misrepresentation or the facts that were not properly disclosed. The rescission, if successful, voids the coverage ab initio (i.e., “from the beginning”), which means the coverage never existed. The risk of rescission is that insureds who thought they were adequately covered by the D&O policy could find out that they, in fact, have no protection because of a misrepresentation in the application process by someone else.

In North Carolina, the insurer may rescind the policy by “showing that the insured made representations in his application which were material and false. . . . It is not necessary that the representation be intentional.” **Puttman v. First Protection Life Ins. Co.**, 72 N.C. App. 428, 433, 325 S.E.2d 287, 291 (1985). A “representation in an application for an insurance policy is material ‘if the knowledge or ignorance of it would internally influence the judgment of the insurer in making the contract, or in estimating the degree and character of the risk, or in fixing the rate of the premium.’ ” **Crawford v. Commercial Union Midwest Ins. Co.**, 147 N.C. 455, 460, 556 S.E.2d 30, 34 (2001).

Some policies provide that the insurer may rescind based on false information outside the actual application, for example, SEC filings or press releases. That information is put out into the marketplace and the underwriters may review and rely on such public pronouncements.

Accordingly, more attention needs to be paid to the statements made in the application and underwriting process. The application should be reviewed by appropriate people—who may include the CEO, CFO, General Counsel, Risk Manager, or VP of Marketing—to make sure accurate information is being supplied and that accurate information is being disseminated. The application should not be treated as a simple clerical or administrative task to be delegated to the broker.

Since rescission may be catastrophic to “innocent” insureds, the company should have a “severability” clause in the policy applicable to representations in the application process. Attention must be paid the wording of this provision. Simply, the clause may preserve coverage for “innocent” insureds, even if other insureds misrepresent material information in the application.

There are different types of severability provisions. A “full” severability clause will state that the application is deemed to be a separate application by each insured or that the knowledge of one insured is not imputed to another insured for purposes of the application. For Side C—entity coverage—a full severability provision should provide that only the knowledge of certain officers of the corporation will be imputed to the entire corporation to determine whether the policy may be rescinded.

Under a limited severability provision, the knowledge of the person signing the application, or the knowledge of certain designated executive officers, is imputed to all insureds and could be used to rescind the policy. Knowledge of other persons would not be imputed.

Severability may also apply to different coverages. The company should seek express language in the policy detailing the only situations where the

insurer may rescind. For example, severability may mean that only certain coverages may be rescinded. Some policies provide that Side A coverage is nonrescindable as to all insureds. Alternatively, the language may provide that Side A coverage can be rescinded, but only as to the person who had knowledge of the misstatement in the application. Some policies provide full severability as between insureds for Side A coverage but no severability for the corporation. Therefore, an insured person’s knowledge could be imputed to the corporation and support rescission of the corporation’s coverage in Side B and Side C coverages.

Rescission is even more problematic where the D&O policy also includes employment practices liability coverage. Employment claims against the company may be more common than classic director and officer claims. Therefore, the company should try to separate out the employment practices coverage for any rescission claim of Side A, Side B or Side C coverages.

There may be a conflict between the policy wording regarding rescission and the statutes and case law of the applicable jurisdiction. Policy language which makes rescission more difficult than stated in statutes may be enforced. However, policy language which would make rescission easier than stated in statutes is unlikely to be enforced. Regardless, the best defense against a possible rescission claim is care in completing the application and responding to all requests for information during the underwriting process.

#### **Claims Definition & Reporting Issues**

Nearly all D&O policies are “claims-made” rather than “occurrence based” policies. “Claims-made” policies are those where the policy is triggered if the “claim” is made within the policy period. “Occurrence-based” policies are those where the policy is triggered if the occurrence, accident or event takes place within the policy period, regardless of when the claim is made. Even though only the “claim” must be made in the policy period, the policy will have a “retroactive date.” The policy will apply only to “wrongful acts” which happen after the retroactive date. Typically, an insurer will agree to a “retroactive date” only as far back as the initial directors and officers policy was obtained. It is to the company’s benefit to push the retroactive date as far back in time as possible.

The definition of “claim” is crucial in understanding and evaluating the policy. At a minimum, most policies define the term “claim” to include a “written demand for money” and a “civil proceeding.” Obviously, the broader coverage comes with a broader definition of the term “claim.” Given the different kinds of demands which may be made upon directors and officers, especially given new

responsibilities under Sarbanes-Oxley, the company should consider obtaining a broad definition since, typically, the insurer has no obligation to pay for the costs of defense and investigation until there is a “claim.”

An expanded definition of the term “claim” typically includes lawsuits and may include either verbal or written demands for either monetary or non-monetary relief. Additionally, administrative, arbitration or investigative proceedings, as well as criminal proceedings, may also be covered. As a general matter, civil proceedings are defined to commence once an insured has been served with a complaint or similar pleading. A criminal proceeding is typically defined to commence upon the return of an indictment against an insured. Investigative, administrative and arbitration proceedings are generally defined to commence when a notice of charges, investigative order, target letter or similar document is issued.

While expanding the definition of “claim” can be beneficial, it also mandates that the insured closely monitor “claims” in order to timely report them to the insurer. Otherwise, the insured runs the risk of potentially losing coverage. Policies may require that the insured report a claim to the insurer “as soon as practicable” after the claim is first made. Other policies may have a combination of the “as soon as practicable” requirement along with a 30- to 90-day post-policy period window to report claims made within the policy period. To diminish the potential for insureds who inadvertently fail to timely report a claim, insurers may be willing to include policy language that reduces such risk such as providing that the time for reporting claims does not begin to run until a designated person in the corporation actually has knowledge of a claim.

More importantly, a broader definition of “claim” may also mean a broader definition of “potential claim.” Monitoring for “claims” is easier than monitoring for “potential claims.” Insureds have an obligation to provide information of “circumstances likely to give rise to a claim” or “potential claims.” If an insured does so, the policy in effect when that notice is made will respond if and when an actual claim is made against the company or its directors and officers. Failure to do so may create a gap in coverage where the potential claim is in one policy period, but the actual claim comes in a subsequent policy period. The first policy may not apply because there is no “claim,” and the subsequent policy may not apply if it excludes coverage for “potential claims” which have not been reported to the insurer prior to policy inception. Again, this danger may be ameliorated if the policy does not require reporting until a designated person in the

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company has actual knowledge of the “potential claim.”

The company must be careful when switching insurers. The retroactive dates should match. There should be no gaps in time between the policies. If the retroactive dates do not match, then the company will have to purchase extended discovery period coverage, which may be quite costly.

### Is Policy for “Damages” or “Loss”

D&O policies may promise to pay for either “damages” or “loss.” Both will be defined terms. “Loss” typically includes “damages, judgments, settlements and defense costs.” Thus, it is more expansive than “damages.” Policies generally carve out certain categories of “damages” including certain fines, punitive damages, multiplied damages and matters which may be deemed uninsurable under the law. Of particular concern are judgments which simply act to disgorge money from directors and officers. These “recoupment” actions, some insurers argue, are not for “damages.” At least one court has held a D&O policy did not pay for a securities claim, because the remedy sought was disgorgement which was not “damages.” **Level 3 Communications, Inc. v. Federal Ins. Co.**, 272 F.3d 908 (7th Cir. 2001). The **Level 3** case involved a “bump up” securities fraud claim. Plaintiff were sellers of securities who sought additional compensation from the buyer, Level 3, to account for Level 3’s misrepresentations prior to the sale. Level 3 paid \$11.8 million to settle the lawsuit and then sought coverage for the settlement under its D&O policy issued by Federal Insurance Company. In his decision, Chief Judge Richard Posner of the Second Circuit Court of Appeals endorsed the argument that “a loss within the meaning of an insurance contract does not include the restoration of ill-gotten gain.” 272 F.3d at 910. Judge Posner held that the relief plaintiff sought was “restitutionary in character” and that “an insured incurs no loss under the meaning of the insurance contract for being compelled to return property that it had stolen, even if a more polite word than ‘stolen’ is used to characterize the claim for the property’s return.” *Id.* at 911. Accordingly, insureds should seek to modify the definition of “loss” to include punitive, exemplary and multiple damages, as well as any remedy - including recoupment or disgorgement - sought in securities claims.

### Coverage for Criminal Indictment/ Subpoena

A potentially valuable coverage is for costs incurred in responding to government subpoenas. These subpoenas may precede an actual “claim.” Nevertheless, responding to subpoenas may cost

tens or hundreds of thousands of dollars. The company, faced with a subpoena, also may wish to have counsel involved early to evaluate possible exposure to both civil and criminal liability. Since there is no “claim,” the typical D&O policy will not pay for those expenses, even though this early response may determine what eventually may happen on a future claim. While notice of a “potential claim” to the insurer is required by the company, the typical policy does not pay for pre-claim expenses. Companies should investigate the cost of such additional coverage.

Similarly, criminal indictments may precede a civil “claim.” Defense of the criminal case will certainly have an impact on any civil “claim,” yet the typical policy will not pay for the defense. Some policies extend the definition of “claim” to include “criminal” matters. The company should investigate the cost of such additional coverage.

### Fraud Exclusion

D&O policies ordinarily contain an exclusion for liability that arises from an officer or director’s fraud or dishonesty. Usually, this exclusion requires a final judicial determination of intentional wrongdoing in the underlying lawsuit in order for the exclusion to apply. The insurance company must advance defense costs until such a determination is made. However, given that most claims are settled, the insurance company is obligated to fund a reasonable settlement despite the possible application of this exclusion, when there has been no finding of wrongdoing. In recent years, some insurers have begun to remove the final adjudication limitation or to add language that the final adjudication can be in a separate declaratory judgment action.

### Personal Profit Exclusion

Generally, D&O policies exclude coverage for loss in connection with claims arising out of or based upon a director or officer gaining any personal profit, remuneration or advantage to which such person was not legally entitled. Restrictions on trading stock during a blackout period as outlined in the Sarbanes-Oxley Act or the repayment of bonuses are situations where a claim could be made against an officer or director and the exclusion could come into play. Insurers will rely on this exclusion where the definition of “loss” extends to disgorgement or reimbursement claims.

Policy wording may be crucial. If the word “such” or a similar word is included in the exclusion before the phrase “directors or officers gaining in fact any personal profit, advantage or remuneration to which they were not legally entitled,” then the exclusion is intended to apply only to the

person who received the illegal profit. If the word “such” is not included, then the exclusion may apply even to directors and officers who did not gain any illegal profit.

The typical “personal profit” exclusion applies to settlements and does not require a judicial determination of an actual personal gain. Insurers will use the exclusion, where applicable, to decline to fully fund settlements on the basis that some of the liability is excluded. To minimize the insurer’s ability, the company should seek the same type of “final adjudication” modification found in the fraud exclusion so that it applies only to judgments where there is a final adjudication of improper personal profit.

### Insured v. Insured Exclusion

All policies will contain some version of an “insured v. insured” exclusion. The exclusion has potentially large application. Board members may sue officers and directors. Board members may sue board members. Employees may sue officers and directors. In part, the scope of the exclusion depends on the definition of “insured.”

The company should seek to minimize the effect of this exclusion. For example, it should not apply to Employment Practices claims. It should have an exception for suits by a trustee in bankruptcy, who is suing in a representative capacity. It should not apply to shareholder or securities actions.

### Allocation

Many lawsuits seek to recover different kinds of damages under different theories. Thus, only part of a “claim” may be covered. While commercial general liability policies agree to pay for all costs of defense, even where part of the claim is not covered, D&O policies frequently have a provision permitting the insurer to “allocate” defense costs, settlements or judgments between covered and non-covered claims and covered and non-covered parties.

Initially, the company should seek a policy without any allocation provision, especially as to the costs of defense. Failing that, the company should seek to narrow the effect of such a provision.

D&O policies often address allocation in one of two ways. First, some policies contain provisions predetermining the allocation of a claim. The provision may set a minimum allocation percentage where the insured pays a percentage and the insurer pays the remainder. A provision may predetermine allocation by counting claims and covered parties.

Predetermined allocation provisions generally are used with respect to Securities Claims because

of the number of disputes it generates and the relatively small range of potential allocation percentages involved.

A second approach is to have the insured and insurer allocate based on the specific case. These provisions generally require the insured and the insurer to use their “best efforts” to agree upon a fair and reasonable allocation under the circumstances of the claim. Depending on the relationship with the insurer, this may be a smooth process or lay the groundwork for an adversarial confrontation. Some jurisdictions apply a “larger settlements rule,” which provides that if both covered and uncovered claims are settled, the insurer must pay the entire amount, unless it can show that the settlement was larger than it otherwise would have been because of the uncovered claims. The same approach may be used with respect to defense costs. Another method is to allocate based upon relative legal exposure of the covered and uncovered claims and covered and uncovered parties. This approach is more difficult, and it may place defense counsel in an awkward position as the evaluation would impact the defense lawyer’s two clients—the insurer and the company—differently. Defense counsel may resist making such an evaluation, which then requires the company and insurer to each hire separate counsel to make an independent evaluation.

If there is to be any “allocation,” the company should treat “allocation” as a business decision. The insurance company certainly will treat it that way. Simply, there is always a deal which can be made, regardless of what the policy states. The difficulty is assessing when the deal is to be made. What appear to be favorable early allocation agreements may not turn out that way.

#### **Hammer Clauses**

Many D&O policies provide that an insured cannot settle a claim without first obtaining the insurer’s written consent. The company should modify this provision so that insurer’s written consent cannot be “unreasonably withheld.”

Some D&O policies provide that where an insured does not agree to a settlement with a third party, proposed by the insurer, then the insurer’s liability will not exceed the amount of the proposed settlement. This provision is often referred to as the “hammer” clause because of the power it gives to the insurer to force a settlement. Directors and officers normally would resist settlement where they do not believe they are liable to the claimant. However, if there are potentially large damages—well in excess of the proposed settlement amount—the directors and officers would succumb to avoid the extra exposure. The company should attempt to delete “hammer” clauses from a policy, or at a minimum, limit the application of the clause to only when the insured

has “unreasonably” withheld its consent to settlement.

#### **Selection of Counsel Provision**

Most D&O policies do not obligate the insurer to defend the policyholders. Instead, the policy usually obligates the insurer to pay all “loss” that any director or officer is legally obligated to pay, and the term “loss” is usually defined to include attorneys’ fees incurred in defending a legal action. In the past, one of the most contested issues was when the insurer had to pay defense costs—did it have to pay them as the policyholder incurred them or could it wait until the underlying litigation was concluded. Most courts that addressed the issue held that the insurer had a duty to advance defense costs as they were incurred. Currently most D&O insurers agree in

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the policy to advance defense costs as incurred but a few have included language explicitly removing any duty to contemporaneously pay defense costs.

The policy may outline when, where and what type of claim expenses may be incurred. Most policies provide that the insurer has no obligation to pay for expenses which are incurred without express prior consent of the insurer. Therefore, immediate notice to the insurer is extremely important. Some policies will “pre-approve” “panel counsel” for certain types of litigation, such that defense expenses from those lawyers would be covered. There should be a list with the policy. Regardless, the company should negotiate with the insurer to get its preferred counsel for securities, employment practices or general claims on a pre-approved list. Otherwise, much time and effort may be spent in negotiating with an insurer while a claim is proceeding. More time

and effort may be spent in discussing why the insurer will not pay for claims expenses incurred before notice was given to the insurer, even where the claim required an immediate response, as where the company is served with a motion for a temporary restraining order or injunction.

Even where the insurer has a duty to defend, some policies permit the company to assume the defense and control counsel, with the insurer’s consent. That consent is likely to be tied to the billing rates of the company’s selected counsel.

Some Director & Officer claims, with concomitant claims against the company, have the potential to become “bet the company” cases, for example, large or class action employment discrimination suits or suits regarding theft of trade secrets (if there is not an applicable exclusion). Claims against the individuals may become “bet your life savings” cases as the size of the WorldCom individual settlements demonstrate. Accordingly, being comfortable with the defense counsel could be essential to reducing the otherwise high stress associated with the lawsuit.

#### **Conclusion**

In reviewing a D&O Policy, the company needs to carefully consider the purposes it wishes the policy to serve. The ability to protect directors and officers may give the company a competitive advantage in attracting and retaining excellent persons to serve as directors and officers. Insurance is but one, albeit a significant one, piece of the program to shield directors and officers from personal financial liability. Careful review and negotiation with the insurer over the terms of a policy should lessen the potential negative impact if and when claims do arise. The company should consult extensively with its insurance agent or broker. However, given the agent’s own proprietary interest, the company should have proposed policies and existing policies reviewed by outside persons with no financial interest in the sale of a policy. There are insurance consultants who do not sell policies. Law firms with insurance and corporate practices are an ideal resource, as they bring to bear their knowledge of the insurance policies and how the terms have been applied by courts, as well as their knowledge of corporate law and the non-insurance methods for protecting officers and directors. Regardless, the company should not simply pay a premium and file the policy away, hoping it never needs to be reviewed. ■

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