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D&O Insurance Protection of Governing Persons

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I. Understanding the Basics of D&O Insurance

A. The Insuring Clause of the Policy: The Heart of the Policy

In every policy, the "insuring clause" or "insuring agreement" is the heart of the policy. It sets forth the insurer's agreement about coverage. Generally, there are, at least, two "insuring clauses" or "insuring agreements" in a D&O policy: (1) individual director and officer coverage and (2) corporate indemnity reimbursement coverage. A third type of insuring agreement, corporate entity coverage, is optional but often limited to securities and employment claims. Each of these clauses is addressed below.

1. Individual Director and Officer Coverage

Most companies indemnify their directors and officers through corporate bylaws or board resolutions. While there are certain limitations, this type of corporate indemnification is normally quite broad. A D&O policy, under this type of coverage, will provide individual director and officer coverage only in those instances where the company does not indemnify the director or officer. Here is an example of this type of insuring agreement:

Coverage A: Directors and Officers Insurance

This policy shall pay the Loss of each and every Director or Officer of the Company arising from any claim or claims first made against the Directors or Officers and reported to the insurer during the policy period . . . for any alleged Wrongful Act in their respective capacity as Directors or Officers of the Company, except for and to the extent that the Company has indemnified the Directors or Officers.

2. Corporate Indemnity Reimbursement Coverage

This coverage generally applies to the extent that the company has indemnified the director or officers pursuant to common law, statutory law, contract, company charter, or company bylaws. In this instance, the insurer is obligated to reimburse the company for the amount indemnified by the company. Here is an example of this type of insuring agreement:

Coverage B: Company Reimbursement Insurance

This policy shall reimburse the Company for loss arising from any claim or claims which are first made against the Directors or Officers and reported to the insurer during the policy period . . . for any alleged Wrongful Act in their respective capacities as Directors or Officers of the Company, but only when and to the extent the Company has indemnified the Directors or Officers for such loss pursuant to law, common or statutory, or contract, or the charter or bylaws of the Company duly effective under such law which determines and defines such right of indemnity.

3. Corporate Entity Coverage

The original intent of D&O insurance was to protect the personal assets of the directors and officers of a company. Originally, D&O insurance was not intended to protect the company. Thus, when a director or officer was sued along with the company, the D&O insurer would often take the position that, since the company was not covered under the policy, it was responsible for only a portion of the defense costs and indemnity amounts paid in the litigation. This inevitably resulted in major "allocation" debates between D&O insurers and their insureds. Insurers would argue for an allocation that minimized the covered loss (i.e., placing most of the cost toward the company). In contrast, the insureds would argue for an allocation that maximized the covered loss (i.e., placing most of the cost toward the directors and/or officers).

The "allocation" debate became less important when insurers introduced "entity" coverage. This type of coverage provides coverage directly to the company. However, in most policies, it is limited to securities claims and employment claims made against the company. This type of supplemental coverage is provided to the insured at a higher premium. Here is an example of this type of insuring agreement:

The insurer shall pay on behalf of the Company Loss resulting solely from any Securities Claim first made against the Company during the Policy Period or, if applicable, the Optional Extension Period, for a Company's Wrongful Act.

[1] Special thanks to Laurel Brewer for her contributions to this paper.

NOTE ON EMPLOYMENT PRACTICES LIABILITY COVERAGE

An organization's D&O insurance will probably not cover claims such as sexual harassment, discrimination, or wrongful termination, unless the policy contains an Employment Practices Liability (EPL) endorsement (also known as a "rider"). Corporations should consider procuring this extension to their D&O coverage.

When purchasing EPL coverage, an organization should remember the following:

- The EPL rider should cover non-officer employees.
- EPL endorsements may contain an "insured versus insured" exclusion, meaning suits by some directors and officers against other directors and officers would not be covered. *See infra* at 13-14 for a more complete description of this exclusion.
- EPL endorsements may not cover claims for emotional distress and mental anguish arising from otherwise covered conduct.
- Not all EPL riders cover the entity itself. This may be good for directors and officers, but bad for the organization. *See infra* at 20-22 for a more complete analysis.
- Stand-alone EPL insurance is also available. However, it does not provide the general D&O coverage that directors and officers may prefer.

See Joseph P. Monteleone & Emy P. Grotell, *Coverage for Employment Liability Under Various Policies*, 604 PLI/Lit. 355, 390-98 (1999). In shopping for the right EPL coverage, a corporation should negotiate with potential carriers to minimize the restrictions and maximize the coverage under the endorsement.

B. The Important Distinction Between "Claims-Made" Policies and "Occurrence" Policies

Most D&O policies are "claims-made" policies, and it is important to understand the distinction between this type of policy and an "occurrence" policy.

- **Occurrence-based policy**

  This type of policy is triggered if the occurrence, accident, or event takes place within the policy period, regardless of when the claim is made.

- **Claims-made policy**

  This type of policy is triggered if the "claim" is made within the policy period, regardless of when the occurrence, accident, or event took place.

Under a D&O policy (which is often a claims-made policy), the claim against the director, officer and/or company must be made ***during the policy period*** and must be for an alleged "Wrongful Act." While the "Wrongful Act" need not be committed during the policy period under most policies, many D&O policies provide a "retroactive date," which is the earliest date a "Wrongful Act" can take place and be covered under the D&O policy. It is therefore important for the policyholder to understand whether the D&O policy has a retroactive date and how early that date is.

There are also variations of the "claims-made" policy form. The more restrictive form is called a "claims-made and reported" policy form. Under this form, not only does the claim have to be made during the policy period, but it also must be reported by the insured to the insurer during the policy period. The more policyholder-friendly form does not require that the insured report the claim during the policy period. Instead, it simply requires that the reporting take place "as soon as practicable" or similar language.

C. What Is A "Claim" and How Broadly Is It Defined Under the D&O Policy?

Since most D&O policies are "claims-made" policies and since the "claim" must be made within the policy period, it is therefore critical for the policyholder to understand how the policy defines the

Title search: D&O Insurance Protection of Governing Persons

Also available as part of the eCourse
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