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What your Management Team Needs to Know About Directors and Officers Liability Insurance

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WHAT YOUR MANAGEMENT TEAM NEEDS TO KNOW ABOUT DIRECTORS AND OFFICERS LIABILITY INSURANCE

OVERVIEW

Analysis of insurance coverage cases over time reveals that insurance decisions frequently foreshadow changes in insurance policy provisions. Nowhere is this phenomenon more apparent than in the context of Directors and Officers ("D&O") liability insurance policies.

This Article compiles and summarizes some new "hot topic" cases, as well as some of the best examples of recent D&O decisions from around the country that either have, or may, lead to changes in policy language. Your management team can benefit greatly from knowing what may be coming at the next D&O renewal, and you can strengthen your D&O negotiations by following the recommended practice pointers for enhancing coverage or avoiding coverage traps.

Because coverage restrictions appear not only in exclusions, but also in other parts of the policy, this Article explores "hot topics" found in several different sections of D&O policies.

I. CONDITIONS

A. Notice

The claims-made nature of D&O policies guarantees that courts will continue to wrestle with notice issues well into the future. Notably, the Texas Supreme Court focused on notice in a recent D&O pronouncement, *Prodigy Communications Corp. v. Agricultural Excess & Surplus Ins. Co.*, 288 S.W.3d 374, (Tex. 2009). In *Prodigy*, the claims-made D&O policy issued by Agricultural Excess & Surplus Ins. Co. ("AESIC") contained the following notice provision:

> The [Insureds] shall, as a condition precedent to their rights under this Policy, give the Insurer notice, in writing, as soon as practicable of any Claim first made against the [Insureds] during the Policy Period, or Discovery Period (if applicable), but in no event later than ninety (90) days after the expiration of the Policy Period or Discovery Period, and shall give the Insurer such information and cooperation as it may reasonably require.

288 S.W.3d at .

The AESIC policy insured Flashnet, a company with whom Prodigy merged in 2000. In anticipation of the merger, Flashnet purchased a three-year Discovery Period, extending the time within which to report claims from May 31, 2000 to May 31, 2003.

Flashnet was sued in a class action securities lawsuit on November 28, 2001. Although Prodigy was served with the lawsuit in June of 2002, it did not send AESIC formal notice of the lawsuit until June 26, 2003, within ninety (90) days after expiration of the Discovery Period. AESIC nevertheless denied coverage for the lawsuit, contending that Prodigy failed to provide notice "as soon as practicable."

Acknowledging that the claims-made limitation (notice no later than 90 days after expiration of the Discovery Period) defined the limit of AESIC's coverage obligation in contrast to the "as soon as practicable" limitation which served merely to provide AESIC with the maximum amount of time within which to investigate the claim and guide it toward resolution, the Court concluded that Prodigy's obligation to provide AESIC with notice of a claim "as soon as practicable" was not a material part of the D&O policy at issue. For this reason, the Court held that in the absence of prejudice (which AESIC admitted was absent here), the insured's failure to give notice "as soon as practicable" would not defeat

coverage as long as the insured timely notified the insurer of the claim within the policy term or other specified reporting period.

***Practice Pointer* – Not only are insurers trending away from "as soon as practicable" notice language in favor of more specific notice requirements, but also a few carriers now attempt to enforce time limitations that are shorter than the end of the policy period; e.g., within sixty (60) days of receiving notice of the claim. Most of these shortened time limitations can be extended or removed through negotiations with the underwriter, but be sure to review every D&O insurance policy for the applicable notice and reporting requirements prior to binding the coverage.**

Another interesting case from California underscores an insurer's penchant for demanding strict compliance with all technical details of the notice requirements. In Oakland – *Alameda County Coliseum, Inc. v. National Union Fire Insurance Company of Pittsburgh, PA, et al.*, 480 F.Supp.2d 1182 (N.D. Ca. 2007), the court considered a claims-made-and-reported policy issued by National Union to the Oakland – Alameda County Coliseum ("OACC") providing D&O insurance to OACC for the policy period "July 01, 1996 to July 31, 1997 (12:01 a.m., Standard Time at the address stated in Item 1)."

Believing that a lawsuit between OACC and the Oakland Raiders football team was imminent, on July 31, 1997, OACC sent its insurer a letter entitled "Notice of Claims and Circumstances," identifying, in 13 numbered paragraphs, various facts and descriptions of items OACC thought might constitute claims or circumstances that could give rise to claims between OACC and the Raiders. Among other reasons, National Union rejected OACC's "Notice of Claims and Circumstances" because OACC sent the letter during the day on July 31, 1997, after the policy had expired at 12:01 a.m. that morning. In other words, according to National Union, OACC failed to comply with the "claims-made-and-reported" requirement because it failed to timely report any alleged claim before the policy expired.

Rejecting OACC's ambiguity argument, the court held that OACC had failed to provide notice to National Union on or before the policy expiration date because it sent its notice after 12:01 a.m. on that date.

***Practice Pointer* – Although the result in OACC may seem hyper-technical, it is worth noting that most insurance policies incept and expire at 12:01 a.m. Therefore, an insured who wants or needs to give notice prior to an expiration date should make sure that notice is given on the day before the date specified in the policy.**

B. Notice of Circumstances

D&O policies, like most claims-made policies, contain a policy holder – friendly provision called a "notice of circumstances." As discussed in *OACC* above, a notice of circumstances provision enables the insured to report to the insurance carrier facts or circumstances that may give rise to a claim before an actual claim has arisen. If a claim or lawsuit subsequently arises out of those circumstances, the claim or lawsuit "relates back" to the date on which the original notice of circumstances was given. In this way, insureds can "park" claims in prior policy years (where limits may not be depleted) or avoid losing coverage in subsequent policy years if the insurer believes that a claim was made prior to the inception of the policy. Although most D&O insurance policies provide some guidance regarding the amount and specificity of information required for a notice of circumstances to be effective, disputes still abound regarding the adequacy of the notice given. While an insurer wants enough information to understand, investigate and evaluate the risk, an insured may not have much substantive information at the time of notice because the circumstances have not yet amalgamated into a claim. This tension between the insurer

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