

D&O INSURANCE: THE BASIC VALUE PROPOSITION

We’ve all heard the well-worn saying about people who “Can’t see the forest for the trees”. The battle between the details and the big picture plays out every day in the D&O industry and while we spend the vast majority of our time studying the trees in minute detail, it is also important to think about the forest.

A D&O insurance policy is a lengthy contract and the details are extremely important. Our D&O insurance professionals labor over the contract’s terms and conditions to optimize coverage and are vigilant students of judicial decisions and the ever-evolving regulatory landscape. Our attention to such matters helps us navigate through coverage analyses with the intent of improving and enhancing coverage for our clients. However, at times, it is appropriate to step back and look at the big picture – to set aside our microscope and instead view the policy with a wide angle lens.

This article will serve as a departure from our usual approach. By design, this article will center on the responsiveness of a D&O Policy by concentrating on the policy’s basic value proposition. We will resist the urge to delve into policy intricacies and instead provide a fundamental discussion of the underlying principles of a D&O policy.

The basic value proposition of D&O Insurance is that, subject to all of the other policy terms and conditions, it provides coverage for (1) Loss (2) arising from Claims made during the policy period (3) alleging a Wrongful Act (4) against an Insured acting in an Insured Capacity (5) that is not otherwise excluded under the policy. These five items are easily stated, but they are also the source of a very large portion of the coverage disputes that arise under D&O policies.

In order for there to be coverage, all five of these requirements must be met. For instance, simply incurring a Loss is not enough to trigger coverage. Policyholders sometimes struggle with this, out of the belief that if they are incurring legal fees,

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they ought to be able to recover under the D&O policy. Unfortunately, the policy does not trigger until there has been a claim that falls within the policy's definition of Claim.

Another disconnect arises when a policyholder has concerns about a possible legal dispute, and as a result, hires counsel. The concern itself is not a Claim, but the concern may be specific enough for the policyholder to provide the carrier with a notice of circumstances that may give rise to a Claim. The notice of circumstances essentially "anchors" the situation in the policy in which the notice was provided (which means that any subsequent Claim arising from the circumstances will be deemed first made as of the date of the notice). The provision of a notice of circumstances by itself is not a Claim and does not trigger coverage. It is also important to note that there is no coverage for legal fees incurred before an actual Claim is made, and the fees incurred before the Claim will not satisfy the applicable retention.

Another example of a situation where there is no coverage unless all five requirements are met arises when there is a Claim, but no Wrongful Act has been alleged. This might happen if the policyholder is served with a subpoena as the carrier may contend that the subpoena is not a Claim. Some policyholders have succeeded in arguing that a subpoena is a Claim (and well-negotiated modern D&O policies may even include service of a subpoena within the Claim definition). However, even if a policyholder is successful in arguing that the subpoena is a Claim, the policyholder may face the further argument from the carrier that the subpoena does not allege a Wrongful Act.

In addition to the requirement that the action involved must meet the policy's definition of Claim, the Claim must be first made during the policy year in order for there to be coverage. While it might seem that determining the claims-made date should be straightforward, it can often be a source of problems. An example of a situation where problems might arise is when the lawsuit is merely the final step in the course of a long-running dispute that involved numerous threatening letters and demands that took place before the policy's inception date. Another example comes when a complaint is filed before the policy period but not served until after the policy's inception date (for instance, when a claimant files a qui tam action; the complaint may be filed years before it is finally served on the policyholder).

When discussing the D&O policy's coverage for individual insured persons, it is important to note that coverage is only available for defined Insured Persons. Questions can sometimes arise about the status of persons who are named as defendants in a complaint. For example, is the individual an officer of the company or merely an employee? Is the person an officer of a joint venture or other enterprise that is not a subsidiary of the company?

In order for the claim against an individual to be covered, the Insured Person must also have been acting in an insured capacity at the time of the alleged Wrongful Act(s). Problems can emerge, for example, if the person was acting in a personal capacity rather than as a director or officer of the company. Another example involves a situation where a representative of a private equity firm sits on the board of one of the firm's portfolio companies. Questions may arise, about whether the person was acting as a representative of the private equity firm or in his or her capacity as a director of the portfolio company.

Naturally, the policy exclusions are also essential to the question of whether the D&O policy will respond. Some exclusions are simply meant to differentiate between insurance policies in the policyholder's insurance program. For example, the typical D&O insurance policy will exclude bodily injury and property damage, as those matters are addressed in the policyholders CGL policy. The D&O insurance policy will also exclude claims under ERISA, as those claims are covered under the fiduciary liability policy.

Some exclusions are meant to preclude coverage for certain kinds of claims. For example, most D&O insurance policies preclude coverage for claims by one insured against another insured. The purpose of the exclusion is to prohibit coverage for claims that involve in-fighting or that may be collusive. However, the exclusion usually has numerous exceptions that carve-back coverage for certain types of claims. Whether any particular claim is precluded from coverage will depend not only on what is alleged, and by whom and against whom, but also the specific wording of the exclusion.

In some instances, it may not be clear at the outset of the claim whether a particular policy exclusion is applicable. An example is a claim alleging fraud. Most D&O insurance policies have an exclusion precluding coverage for fraud. However, mere allegations alone are not sufficient to trigger the exclusion. Depending on the specific wording of the clause, the exclusion may only be triggered if there has been a final adjudication that fraud has been committed.

While the basic value proposition of a D&O insurance policy is simply stated, the actual operation of the policy will still depend on a wide variety of factors. Whether any particular matter is covered could prove to be a complicated question. Thus, even though the basic insurance mechanism of the D&O Insurance policy can be boiled down to a short list of items, the policy itself and its operation can be complicated. The specific wording of these basic provisions, and of all of the other policy terms and conditions, will determine whether the policy provides the desired level of coverage.

There is no standard D&O insurance policy. Each D&O insurance carrier has forms that differ from their competitors', and most policies are generally the subject of extensive negotiations. In order for D&O insurance buyers to be assured that they have the broadest available terms and conditions and appropriate insurance structure, it is critically important that they select a knowledgeable and experienced broker to assist in their procurement of the insurance. The best brokers also have skilled and experienced claims advocates available to protect their clients' interests in the event of a claim.



ABOUT RT PROEXEC

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