

A PRIMER ON DIRECTORS AND OFFICERS' LIABILITY INSURANCE

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Practice Areas

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What is D&O Insurance?

Directors and Officers liability insurance is one of the most important, yet least understood types of coverage. Regardless of how carefully they conduct business, directors, officers and managers make many difficult decisions that sometimes lead to accusations that they have acted wrongfully. For-profit companies, non-profit organizations, educational institutions and privately held companies purchase this type of insurance to protect the company and its directors, officers and managers by providing them with liability coverage.

D&O policies provide liability coverage for monetary damages in order to protect corporate managers from claims which may arise from the decisions and actions taken within the scope of their regular duties. This has become more critical as companies expand their interstate commerce and international business, with varying regional requirements for legal compliance, complicated auditing and risk management practices and understanding various governmental expectations. Increased exposure leads to the need for increased protection.

What is Covered?

D&O policies cover the personal liability of officers as individuals (Side A coverage) or alternatively, the reimbursement of the company when it has paid the claim of a third party on behalf of its managers (Side B coverage). The policies also cover claims against the company arising from the trading of its securities (Securities Coverage).

Some policies also cover Employment Practices Liability Insurance ("EPLI"). The goal of this coverage is to protect officers and directors from claims brought by employees and certain third parties for allegations such as wrongful termination, failure to promote, sexual harassment and discrimination.

What is a "Wrongful Act"?

The purpose of D&O Coverage is to provide financial protection for companies and managers against claims of officers', directors' and managers' "wrongful acts" when acting in the scope of their official duties.

The definition of "wrongful act" plays an important role in determining whether a D&O claim is covered. Put simply, a "wrongful act" is an action or decision that is considered to be wrongful by another party.

The policy definition is broad. The policies typically define it as an actual or alleged act, error, omission, misstatement, misleading statement, breach of duty, breach of trust or neglect. Coverage includes payment of defense costs in litigation as well as the costs of the financial loss. Some policies also cover costs arising from investigative, administrative or criminal proceedings.



Types of D&O Claims

Claims of wrongful acts can include anything from failing to perform leadership duties with the required expertise to releasing misleading information about the corporation's performance to making defamatory statements. It includes coverage for claims due to both actual behavior and allegations of wrongful behavior even when liability is unclear. The most frequent sources of claims are related to employment issues involving sexual harassment, discrimination or wrongful termination. However, the claims may involve any allegation of wrongful act of a corporate officer, director or manager.

Some of the claims that Newmeyer & Dillion have handled recently involve allegations of art theft, improper corporate management and residential real estate property management. In each of these cases, the insurer initially denied the claims, but we persuaded the carriers to reverse their initial denials.

Who is Covered?

D&O policies vary as to who is covered as individuals. Typically, all current and past directors and officers of a company and its subsidiaries are covered under a D&O policy. The policies also may include non-executive employees. In some cases, the policy may cover not just allegations related to the executive but also the company itself. Further, many D&O policies cover non-compensated volunteers. Therefore, it is not only important to understand what your policy covers at the time it is purchased, but when a company is sued for wrongful conduct, the complaint and the D&O policy should be evaluated for the scope and applicability of coverage.

Timely Submission of a Claim

Unlike commercial general liability policies, which typically cover claims on an occurrence basis which do not limit when a claim may be made as long as bodily injury or property damage occur during a policy period, D&O policies typically grant coverage on a claims-made basis. That means that the claim against the insured must be made while the policy is in effect or during any extended reporting period set out in the policy. Often, these policies also require that the insured report the claim to the insurance company during the policy period. Given these critical time constraints, it is extremely important that the policy is reviewed and that the carrier be notified of the claim as soon as possible.

Common D&O Exclusions

D&O policies do not cover fraud, criminal acts and intentional acts or acts where directors improperly received personal profits or illegal remuneration. Other exclusions include coverage afforded under other types of policies. For example, bodily injury or property damage claims typically would be covered under a general liability policy, so they are not covered under a D&O policy. Also, claims for acts that occurred before the policy period or claims previously made prior to the policy period would be excluded; however, if a claim is made against the insured during the policy period, or in the extended reporting period, those claims may arise from actions that took place prior to the policy itself. Most D&O policies would reach back to cover those actions up to a specified retroactive date set forth in the policy.

D&O Policy Limits

While D&O policies are written to cover legal fees incurred in defending the action involving claims of wrongful acts, the insured should recognize that the policy limits are typically "burning limits" policies where the insurers will pay defense costs within the policy limits. That means that the policy limits will be reduced by the amount the carrier pays to defend the action and only the amount left after the defense costs are paid will be left for indemnification of the insured at trial or settlement.

Right v. Duty to Defend

D&O Carriers usually point out that, unlike a commercial general liability policy, they have a right, not a duty to defend. Therefore, since it does not have a duty to defend, it will not be obligated to select counsel to defend and directly pay



defense costs but will only be obligated to reimburse the insured for the costs of defending the matter using the insured's chosen counsel.

Directors and Officers v. Errors and Omissions

Directors and Officers policies are often confused with Errors and Omissions Policies, but the two are not the same. They apply to different circumstances. Directors and Officers policies protect the director and officer of an insured company from financial liability in the event of a claim regarding perceived failures in their performance and duties as managers. Errors and Omissions policies are concerned with negligence and failure of provision of products and services. It is not unusual for a business to carry both types of insurance.

Errors and omissions policies are generally required by people who provide services directly to clients, such as lawyers, doctors and insurance agents, whereas directors and officers policies are designed to protect a company's decision makers.

Tips for Evaluating D&O Claims

The following points should be evaluated when faced with a claim or lawsuit against your company and its employees, officers, directors or managers:

- If the company receives a pre-lawsuit letter or other notification of a claim against the company and/or its executives, it should immediately notify the insurer of the claim to avoid any issues with the timeliness of the notice. Late notice can be fatal to coverage.
- Do not wait until a matter becomes a lawsuit. Insurers want to know as soon as the claim is made, not just when the lawsuit is filed. Even if you think it is something that can be resolved before litigation begins. Timing is critical!
- When receiving a claim against the company and/or its executives for anything other than bodily injury or property damage, coverage counsel or someone with policy review expertise should evaluate the claim to determine if it could be covered by a D&O policy. Do not overlook possible coverage under this type of policy.
- Coverage counsel or someone with policy review expertise should evaluate who is covered under the policy. The policy may cover more than officers and directors. It may also cover non-management employees or the corporation itself. A thorough review of the policy is necessary when deciding whether to notify the D&O carrier of the claim.

Rondi Walsh is a partner in Newmeyer & Dillion's Newport Beach office focusing in the representation of policyholders in insurance coverage. Her experience extends into business and commercial litigation, having litigated an array of first and third-party insurance matters involving commercial general liability, property, directors and officers, products liability and other policy claims. You can contact Rondi at rondiwalsh@ndlf.com.

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