Lathrop GPM

BLOGS
Policyholder

The Top 5 Pitfalls in D&O Liability Policies

Corporate officers and directors should be able to lead confidently and sleep at night without worrying that their personal assets may be at risk because of personal liability. D&O insurance provides such "sleep at night" coverage for claims alleging breach of their duties. However, there are a few key issues to consider when purchasing a D&O policy that can maximize coverage.

Corporate officers and directors should be able to lead confidently and sleep at night without worrying that their personal assets may be at risk because of personal liability. D&O insurance provides such "sleep at night" coverage for claims alleging breach of their duties. However, there are a few key issues to consider when purchasing a D&O policy that can maximize coverage.

1. Investigation Coverage

D&O policies provide coverage for claims made during the policy period. But is an investigation a "claim" for the purposes of D&O liability insurance? This will largely depend on the language in your policy. D&O policies cover losses stemming from claims made against the insured for a "wrongful act," typically defined as an alleged error or omission in the individual D or O's capacity as such. But, by definition, an investigation is often initiated to determine if such an error or omission occurred, so can an investigation ever involve a wrongful act?

Some D&O policies contain language providing coverage to those who are the "target" of an investigation. While this might seem like a straightforward provision, the government may not inform you of your status as a target, and you may not be deemed a "target" under prosecutorial guidelines until the filing of charges is imminent. As such, one cannot assume investigations are covered. What's the solution from a coverage standpoint? Consider negotiating or amending the definition of "claim" to include circumstances where the D or O is either a subject or target of an investigation.

2. "Reasonable" Legal Fees

D&O policies typically cover "defense costs" — defined as the reasonable costs associated with the defense of a claim. But who gets to decide what is reasonable? Insurers typically have billing guidelines that outline what they consider to be "reasonable" expenses, but these guidelines are virtually never provided until after a claim has been filed, and can often be quite onerous. As a matter of professional ethics, defense counsel cannot allow an insurer's "guidelines" to dictate how they defend a case, so anything your counsel deems "reasonable" should trump anything in the "guidelines." Nevertheless, particularly if you are not using panel counsel pre-selected by the carrier, the carrier will likely insist that your counsel abide by its "guidelines."

What's the solution? Take control of a claim at the outset. To avoid issues related to legal fees, hire lawyers that routinely charge the same rate they charge you and obtain insurer consent to your chosen defense counsel as soon as possible. You may also want to consider negotiating a pre-set allocation for legal fees in your policy. In all events, don't assume that "billing guidelines" are part of the policy; they are not.

3. Insurer Consent

Like most liability policies, D&O policies require written consent from the insurer to incur any costs, but what if you don't have time to obtain your insurer's consent? For example, what if you need to respond to an emergency motion before you have even had time to give your insurer notice of the suit? Some insurers will cover such "emergency costs" by endorsement. Similarly, by endorsement, some insurers will cover costs incurred without consent if within the retention amount. Before you purchase a policy, don't be afraid to negotiate for such language.

4. Prior and Pending Matters

D&O policies typically exclude claims based on "pending or prior" matters. While this language may seem fairly simplistic, it raises several questions. Pending matters against whom? What if the prior matter is totally unrelated to your current claim?

Typically, the "prior and pending" exclusion applies to claims "in any way involving a fact alleged" in a prior (albeit potentially irrelevant) cases. Moreover, depending on your policy form, you may be shocked to discover that the prior and pending exclusion extends to claims against third parties. To avoid these issues, negotiate for policy language limiting this exclusion to prior cases against the insured and to material facts that legally impact a future claim.

5. Public Policy

State laws permit and even mandate broad indemnification of Ds or Os acting in good faith. However, there are some situations where indemnification by the company and/or its insurer may be unenforceable as a matter of public policy. For example, claims involving RICO or antitrust violations, restitution and disgorgement under the Securities Act of 1933, intentional wrongful acts, punitive damages, and regulatory fines and penalties, may be, at least in some respect, non-indemnifiable as a matter of public policy. There may be no way around "public policy" but, at a minimum, consider negotiating for a choice of law provision applying the law most favorable to the insured, and consider negotiating for a defense of such claims even if indemnity may ultimately be denied.

*Maddie Level is a 2019 Summer Associate at Lathrop Gage who contributed to the writing of this blog post.