EXECUTIVE PROTECTION

D&O INSURANCE

The Insuring Agreement

We will discuss the most basic component of the D&O insurance policy — *the insuring agreement*. This basic policy clause contains the most critical terms — the definitions of which often determine whether or not a claim will be covered under the policy.

THE INSURING CLAUSE

Though the precise formulations may (and often do) vary from policy to policy, all D&O insurance policies typically provide coverage for Loss arising from Claims first made during the policy period alleging Wrongful Acts against Insured Persons.

Each one of these nouns or noun clauses in the insuring agreement—Loss, Claims, Wrongful Acts, Insured Persons— are defined terms in the policy, and the specifics of the definitions of each of these terms may be among the most coverage-determinative provisions in a D&O insurance policy.

This document provides a discussion of each of these terms and the claims issues that can arise in connection with each of the terms. It should be emphasized at the outset that the precise contours of these terms have been the subject of extensive litigation over the years. Within the constraints of this article, it is not possible to summarize this litigation or all of the issues that have arisen. Moreover, it is important to note that the specific terms and definitions in any particular policy will determine the claims outcome in specific claims circumstances.

These are the key insuring clause terms, addressed in a slightly different order than they typically appear in the D&O policy:

"CLAIMS MADE"

Many liability insurance policies are "occurrence" policies— that is, the policies provide coverage for accidents or mishaps that occur during the policy period, regardless of when the lawsuit is actually filed. However, D&O insurance policies are not "occurrence" policies, but rather, they are "claims made" policies. That is, D&O insurance policies provide coverage for claims made during the policy period, regardless of when the underlying conduct may have occurred.

Actually, that last statement is not always literally true, as D&O policies may have "past acts" or "retro"dates which specify the date after which the allegedly wrongful conduct must have occurred. In connection with policies that have past acts dates, claims based on conduct that occurred prior to the date would not be covered, even if the claim is made during the policy period.

"CLAIM"

Obviously, in order to determine whether a claim was made during the policy period, a critical question to ask is, "what is a Claim?" Answering that question may be relatively straightforward in the context of civil litigation, as the service of the complaint is relatively easily recognizable as a claim.

The typical D&O policy's definition of the term "Claim" extends much more broadly beyond civil litigation. Most policies' definitions of the term encompass any type of demand for monetary or non-monetary relief, whether or not in the form of a complaint. A letter demand for redress of grievances, for example, though less formal than a civil complaint, typically constitutes a claim under a D&O policy.

In addition, the term "Claim" typically extends well beyond civil litigation to many other types of proceedings. For example, many policies extend the definition to include criminal proceedings, usually with a narrowing provision, requiring the service of an indictment or an equivalent document. Many policies also extend to regulatory or administrative proceedings, although these clauses often include a requirement that these proceedings be "formal."

Further, the term "Claim" is increasingly defined to extend to arbitration and mediation and other types of alternative dispute resolution proceedings.

One of the perennial claims battlefields is whether investigative proceedings constitute a "Claim" within the meaning of a D&O policy. The answer usually depends on the precise wording of the policy definition and the specifics of the investigation involved. Among other frequently recurring questions is whether grand jury subpoenas, informal document requests or other informal inquiries represent claims.

"LOSS"

The term "Loss" specifies the things for which the policy will pay. The term usually encompasses specified indemnity amounts (settlements and judgments) as well as attorneys' fees and other defense costs. (And, it should be noted, the policy's payment of defense fees reduces the amount of insurance remaining under the policy, as payment of defense expenses erodes the limit of liability under the policy). The policy definition also typically excludes payment of certain items, including fines, penalties and matters deemed uninsurable under applicable law.

Among the recurring issues in relation to the definition of "Loss" are questions of coverage under the policy for amounts paid as disgorgement or restitution. These amounts generally are not regarded as "Loss," since they typically represent a defendant's restoration of funds that were never his or hers in the first place. The battleground on these questions, though, is usually over whether or not a specific payment or kind of payment actually represents restitution or disgorgement.

Another recurring D&O insurance question arises in connection with lawsuits filed in the Mergers & Acquisitions context, particularly where the claim is that the transaction price is unfair to shareholders. These claims often are settled with an adjustment of the sales price. The question is whether the additional consideration paid is covered under the policy. These kinds of claims, often referred to as "bump up" claims, frequently recur and often depend on the specific circumstances presented and the policy wording involved. (Many policies today actually have specific "bump up" exclusions.)

"WRONGFUL ACT"

The term "Wrongful Act" is usually defined as an actual or alleged act, error or omission, misleading statement or breach of duty. D&O policies are liability policies, so in order for coverage to attach, the insured person must have done something (or be alleged to have done something) for which they are liable to third parties. Although that might seem pretty straightforward, it can often become tricky in a variety of contexts.

One frequently recurring set of circumstances where the question of whether or not a wrongful act has been alleged is in connection with the investigative proceedings. As noted above, the question of whether or not subpoenas

or informal document requests are claims often arises. However, even if the specific investigative proceedings are claims under the definition of a specific policy, there may still be questions of coverage (again, depending on the specific circumstances and policy language involved) because the subpoena or informal document request does not allege a wrongful act. And, if they do allege a wrongful act, whether or not it is alleged against an insured person.

"INSURED PERSON"

Many D&O policies provide coverage for both natural persons and for corporate entities. Whether or not a person or entity is or is not an insured person under the policy will often depend both on the person's status and on the capacity in which they were acting.

For individuals, the status entitling them as insured persons under the policy is usually their service as a duly elected or appointed officer or director of the company. Whether or not a person is duly elected or appointed will often depend on the insured company's own organizing documents or corporate charter. Questions can sometimes arise about whether or not middle or lower level personnel are insured; these questions are usually best addressed at the time the policy is formed, by endorsing the policy to specify that persons holding specific offices— or even specify particular named persons— are insured persons under the policy.

A frequent concern is whether individuals have coverage after they have completed their board service or officer duties. Most D&O policies include past, present and future director and officers within the definition of insured persons, so a former director or officer should continue to have protection for acts undertaken during their service, at least as long as the company continues to have D&O insurance in place.

Beyond the questions of whether an individual's status entitles him or her to be an insured person under the policy, there are questions concerning the capacity in which an individual was acting at the time of the alleged wrongful conduct. The individuals are insured only for actions in an insured capacity – that is, in connection with their service as a director or officer of the company. These questions can be difficult when the individual has multiple connections with the insured company – as an investor, for example, or as a representative of a private equity or venture capital firm, or where the individual's actions were in connection with a joint venture or other related but separate entity. The capacity in which the person was acting at the time may be a critical issue.

"INSURED ORGANIZATION"

With regard to entities insured under the D&O policy, the typical policy provides coverage both for the insured entity (usually the first named insured) and its subsidiaries. Questions can arise regarding whether or not an entity is a subsidiary (depending on the corporate parent's ownership percentage). Questions can also arise about organizations formed or acquired after the policy's inception. Most policies have very specific policy provisions addressing these subsequent formations or acquisitions.

More complex organizational structures can pose specific challenges. Organizational vehicles such as joint ventures or limited partnerships can pose particularly troublesome concerns if not addressed in the policy. Full exploration of these entity organizational issues are well beyond the scope of this article, but the critical issue is that these organizational questions should be addressed during the insurance acquisition process.

This article's purpose is to offer a macro level discussion of the intricacies of the Insuring Agreement. 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 acquisition 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.

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