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Regulatory: Understanding your D&O insurance policy

D&O insurance can differ significantly from other liability insurance

BY RANDY JOHNSON
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Directors and Officers (D&O) insurance offers vital protection to a company and to its directors and officers against financial claims and liabilities. D&O insurance is unlike other liability insurance in several important respects. First, it generally provides coverage for both the company and its officers and directors, despite the fact that the interests of the insureds often diverge. This aspect of D&O insurance stresses the importance of understanding the basics of a D&O policy.

Although there are a number of variations, a D&O policy typically has three basic insuring agreements, often referred to as Side A, Side B and Side C. Side A covers losses incurred by individual directors and officers for which the company has not provided indemnification. Side B covers losses incurred by the company in indemnifying its officers or directors. Side C covers losses incurred by the company as a result of securities claims made directly against the company.

It is not uncommon for a D&O policy to provide a single limit of liability that is shared among all three insuring agreements and among all insureds. In the event of a claim against both the company and its directors or officers, a single limit policy frequently results in a conflict of interest between the company and its directors and officers as to the allocation of the insurance coverage. Because of this inherent conflict, the following provisions of a D&O policy should be carefully reviewed.

1. *Priority of Payment*. Particularly with single limit D&O coverage, the policy should specify how the insurance proceeds will be prioritized among the various insured parties. D&O policies commonly contain a

priority of payment provision that requires claims against the individual directors and officers be satisfied before claims against the company.

2. *Misconduct Exclusion*. D&O policies typically contain exclusions that bar coverage for misconduct on the part of an insured. The misconduct excluded from coverage generally includes intentional dishonesty, fraud, criminal conduct and willful violations of law. In negotiating coverage, it is advisable to limit the exclusion of coverage to the individual director or officer who committed the misconduct while maintaining coverage for innocent insureds.
3. *Rescission*. If an insurer discovers that the application for D&O coverage contained a misrepresentation or omission of a material fact, the insurer may seek to rescind the policy. A rescission would result in a loss of coverage for the company and all insureds, including innocent directors or officers. Most D&O policies contain some form of severability provision in which the knowledge of one insured is not necessarily imputed to the other insureds. A severability provision may provide, for example, that no insured person's knowledge will be imputed to any other insured or to the company. Some D&O policies take a more direct approach and provide that the policy cannot be rescinded for any reason.
4. *Insured vs. Insured Exclusion*. D&O policies often exclude from coverage a claim brought by one insured against another. The insured vs. insured exclusion may, for example, exclude a claim brought by the company against one or more of its directors or officers, or a claim brought by a director or officer against the company. As with all exclusions from coverage, any insured vs. insured exclusion should be carefully reviewed and thoroughly understood.

Particularly in the post-Sarbanes-Oxley era, D&O insurance provides important protection to companies and to the individuals who serve as directors or officers. A basic understanding of the structure and unique exclusions in a typical D&O policy will help maximize coverage and minimize surprises.

About the Author

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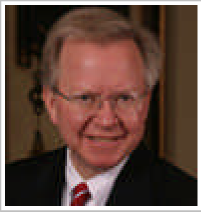

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