

## Directors and Officers Liability Insurance

**Directors and Officers Liability Insurance** (often called **D&O**) is [liability insurance](#) payable to the directors and officers of a company, or to the organization(s) itself, to cover damages or defense costs in the event they suffer such losses as a result of a lawsuit for alleged wrongful acts while acting in their capacity as directors and officers for the organization. Such coverage can extend to defense costs arising out of criminal and regulatory investigations/trials as well; in fact, often civil and criminal actions are brought against directors/officers simultaneously. It has become closely associated with broader management liability insurance, which covers [liabilities](#) of the corporation as well as the personal liabilities for the directors and officers of the corporation.<sup>[1]</sup>

Under the "traditional" D&O policy applied to "public companies" (those having securities trading under national securities exchanges), there are three (3) insuring clauses. These insuring clauses are termed: Insuring Clause 1 (Side-A); Insuring Clause 2 (Side-B); and Insuring Clause 3 (Side-C). Contemporary (competitive) D&O policies also provide for Insuring Clause 4 (Side-D), which provides for a \$250,000 sublimit for investigative costs coverage related to a shareholder derivative demand.

Side-A (Insuring Clause 1) provides coverage to individual directors and officers when not indemnified by the corporation (as a result of state law or financial capability of the corporation) Side-B (Insuring Clause 2) provides coverage for the corporation when it indemnifies the directors and officers (corporate reimbursement) Side-C (Insuring Clause 3) provides coverage to the corporation itself for securities claims brought against it

Note - more extensive (broader) coverage can be obtained for individual directors and officers under a Broad Form Side-A DIC ("Difference in Conditions") policy purchased to not only provide excess Side-A coverage but also to fill the gaps in coverage under the traditional policy, respond when the traditional policy does not, protect the individual directors and officers in the face of U.S. bankruptcy courts from wrongfully deeming the D&O policy a part of the bankruptcy estate and otherwise more fully protect the personal assets of individual directors and officers.

At its roots, D&O insurance insures "behavior" in that the decisions of directors and officers are the matters which often lead to covered claims. That is, an incorrect decision often leads to shareholder discontent and, thus, a lawsuit against the directors and officers who made the decision. State law typically protects the directors and officers from liability (particularly exculpatory provisions under state law relating to directors) but this does not mean that actions are not brought by private plaintiffs (aggravated by the loss of money and seeking a quick payout from insurance proceeds). As such, even innocent errors in judgment by executives will bring D&O insurance into the forefront of the matter; especially because most "D&O" claims are settled before going to trial. The key, apparently, is the motion to dismiss stage of civil litigation (at least in the U.S.A.).

Typical sources of claims include [shareholders](#), shareholder-derivative actions, customers, regulators (including those that would bring civil and criminal charges), and competitors (for anti-trust or unfair trade practice allegations). The extent of coverage is dramatically dictated by

## Directors and Officers Liability Insurance

the fact the company is publicly traded or privately held. For instance, publicly traded companies (themselves) are only covered for securities claims.

In terms of basic state corporate law (at least in the U.S.A.), directors and officers of a corporation can be liable if they damage the corporation by breaching their duties and contracts to the corporation, mix personal and business assets, or fail to disclose conflicts of interest. In the United States, under state corporate law, corporations are often mandated to indemnify directors and officers of companies incorporated in that state in order to encourage people to take the positions. That being said, there exist extensive situations in which either the corporation is only permitted to indemnify the director or officer or the company is explicitly forbidden from indemnifying such director or officer. Liabilities which aren't indemnified by the corporation are potentially covered by certain types of D&O insurance (particularly Side-A Broad Form DIC policies).<sup>[2]</sup> However, the policies have exclusions and must be read carefully.

D&O insurance is usually purchased by the company itself, even when it is for the sole benefit of directors and officers. Reasons for doing so are many, but commonly would assist a company in attracting and retaining directors. Where a country's legislation prevents the company from purchasing the insurance, a premium split between the directors and the company is often done, so as to demonstrate that the directors have paid a portion of the [premium](#). Problems related to income tax liability may come into play when a corporation avoids country specific liability law in order to protect its individual directors and officers through insurance.

A common misperception of D&O insurance is that it makes directors or officers able to engage in acts they know to be wrong; this is not the case. Intentional illegal acts or any illegal gains/profits obtained by directors/officers are not covered under most D&O insurance policies; coverage would only extend to "wrongful acts" as defined under the policy, which may include certain acts, omissions, misstatements while acting as a director/officer of the organization. Exclusionary language, however, would not provide coverage for fraud, illegal profits/gains, or intentional/wanton illegal conduct by such director/officer (as examples).

The basic principle underlying the acceptance of D&O insurance is that companies (and their shareholders) are best served by knowledgeable directors and officers who take strategic risks based upon the information reasonably available to them at the time the decision is made, without the threat of personal liability. By doing so, it is believed, corporations are better able to attract qualified, intelligent, and reasonable directors and officers to manage the operations of the company. Not only would this result in better returns for shareholders but also benefit society in general (due to the increased productivity, jobs created, and advancement of products due to such calculated business decisions). Under the law of states in the U.S.A. and most capitalistic based economies, directors and officers are not "insurers" of their business decisions made in furtherance of the company they serve. This includes the advancement of not only the shareholders, but also the company itself, its customers, and the constituents of the company (such as employees, a particular town, community, charity etc.). In addition to D&O insurance (which fills the gaps), state law ensures that reasonable, calculated, and well-processed decisions (see "business judgment rule"), that are made by the executives of a company, will be made without fear of personal financial loss should their well thought-out plan not come to fruition. As practical and sound as that proposition may sound, it is still within the power of states and

## **Directors and Officers Liability Insurance**

individual companies to deny such executives indemnification for claims that arise out of their well intended efforts. As a result, D&O insurance exists.

In contemporary times (particularly in the U.S.), directors and officers (especially those most sought out by shareholders due to their ability to produce results) are intimately concerned with a company's directors & officers liability insurance program. Under state law, their personal assets are at risk (not to mention their hard-earned reputation). Thus, companies with quality D&O insurance coverage are the most suited to attract the best directors and officers to serve the corporation. Ultimately, it is a cost/benefit analysis...you get what you pay for...

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