The following is a brief, general overview of coverage afforded under the Directors and Officers Liability Insurance Policy and certain common policy terms, conditions, and limitations. The chapters that follow discuss these issues in greater detail and contain descriptions and citations to court decisions that have addressed these issues.

Critical to determining an insurer’s and an insured’s respective rights and obligations in any situation is a thorough analysis of (1) what the policy expressly provides, and (2) what the law is in the controlling jurisdiction.

A. Insuring Clauses

The insuring clauses section of the Directors and Officers (D&O) policy usually contains two separate insuring agreements covering: (1) the individual directors and officers (D&Os), for loss arising from claims against them for which they are not indemnified by the corporate entity; and (2) the corporate entity, for the amount it pays on behalf of the D&Os to indemnify them for loss they sustain.

Originally, the D&O policy was intended to afford coverage solely for claims first made against the corporate insured’s directors and officers (D&Os) during the policy period. Through a combination of soft market forces and court decisions in the mid-1990s with respect to whether insurers were entitled to allocate parts of loss (e.g., settlements or defense costs) to the corporate entity and not to the D&Os, in actions in which both the corporate entity and the D&Os were named, insurers began to add corporate entity coverage to D&O policies. Entity coverage was, and still is, often limited to specific types of claims (e.g., claims alleging violations of the federal securities laws). Consequently, the corporate entity also may be insured for loss it sustains arising from its own wrongful acts. The claim must first be made against the entity during the policy period.

1. Individual Director and Officer Coverage

Part one of the commercial D&O policy typically provides coverage to D&Os, except in those circumstances where the corporation has indemnified them or is
legally permitted or required to indemnify them. Policies usually contain provisions to the effect that corporate indemnification is presumed unless the corporation is incapable of indemnifying the D&Os solely by reason of its insolvency. The deductible or retention applicable to claims falling to Part One is typically nil.

2. Corporate Indemnification Reimbursement Coverage

Part Two of the D&O policy takes several forms. Some policies require the insurer to pay on behalf of the corporation all loss for which the corporation is required or permitted by law to indemnify its D&Os. Other policies provide that the insurer reimburse the corporation, but only to the extent it has already indemnified its D&Os.

Most policy forms provide that Part Two (corporate reimbursement) applies if indemnification by the corporation is required or permitted by law, regardless of whether or not actual indemnification is made, unless the corporation is unable to make actual indemnification solely by reason of its financial insolvency.

Typically, the deductibles or retentions applicable to claims falling to Part Two are much higher than the deductibles or retentions applicable to claims falling to Part One. For certain types of claims (e.g., securities class actions), the deductible can be very high. The deductible applies to all forms of loss, including defense costs.

3. Corporate Entity Coverage

As noted, in the soft D&O market, it became common for insurers to extend coverage to the corporate entity for its own wrongful acts. Coverage may be extended by means of a separate insuring agreement. Some policies may extend entity coverage by including the entity in the definition of “insured” or “insured person.” Entity coverage may be limited only to a particular type of claim; for example, entity coverage for securities claims.

The deductible or retention applicable to the entity insuring agreement usually is high.

B. Definitions

Claim
Some policies define the term “claim” to include a demand for payment or a threat of litigation. Other policies define “claim” as the filing of a legal action. By definition, a claim may be deemed “made” when it is served upon or received by an insured. When the term is not defined in the policy, courts have interpreted “claim” to mean a demand for something, as of right.

Directors and Officers
D&Os typically are defined to include past, present, and future D&Os of the insured entity. In certain policy forms, usually issued only to nonprofit entities or private companies, covered persons also may include volunteers, employees, trustees, and committee members. Coverage for spouses also may be provided.
Employment Practices Claims
D&O policies may extend coverage for Employment Practices Liability Claims ("EPL Claims"). This category of claim generally is defined broadly to encompass the various legal theories that can be asserted by an employee or an applicant against an employer under federal or state law. EPL Claims usually are defined to include actions for: discrimination on the basis of race, religion, sex, or national origin under Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2003–2(a) 1 & (2) (1991)); discrimination on the basis of age under the Age Discrimination in Employment Act (29 U.S.C. § 623(a) (1990)); discrimination on the basis of handicap under the Americans with Disabilities Act of 1990 (42 U.S.C. § 12112) (1991)); violations of the Family and Medical Leave Act (29 U.S.C. § 2615 (1993)); violations of the Equal Pay Act of 1963 (29 U.S.C. § 206(d) (1996)); employment-related defamation; retaliation and retaliatory discharge; wrongful termination; and common law actions based on tort and breach of contract theories.

Loss
The term “loss” generally is defined to include “damages, judgments, settlements and costs, charges and expenses incurred in the defense of actions, suits or proceedings and appeals therefrom.” The term typically excludes “fines or penalties imposed by law, including punitive, treble or exemplary damages, or costs, charges or expenses of grand jury or criminal proceedings and other matters which are uninsurable under the law pursuant to which the policy is to be construed.” Punitive damages may be included in covered Loss in certain situations.

Wrongful Act
The term “wrongful act” generally is defined broadly as “any breach of duty, neglect, error, misstatement, misleading statement or omission by the director or officer committed in their capacities as such.”

C. Trigger of Coverage: Claims-Made v. Occurrence Policies
D&O policies are written on a claims-made basis; that is, the policy implicated is the one in effect when the claim is first made. Coverage is triggered when a claim is made (e.g., a lawsuit is filed) against a director or officer during the policy period and reported in accordance with the notice provisions of the policy. The D&O policy may require that the claim be made and reported during the policy period or reported within a specified period of time after the expiration of the policy. The policy also might provide that notice be given “as soon as practicable.”

Coverage also can be triggered by providing the insurer with “notice of circumstance” that may later give rise to a claim. If the insured is aware of a situation or circumstance and notice is provided to the insurer during the policy period, then any future claim arising out of the noticed circumstance will be deemed to have been made at the time the notice of circumstance was provided.
In contrast to the claims-made policies, occurrence policies cover claims, whenever made, which arise out of wrongful acts or events that occurred during the policy period. Since such claims can be asserted long after the occurrence policy expires, they are said to have a “long tail.” Claims-made policies avoid the uncertainty created by a long tail and thus provide insurers with a more accurate assessment of their exposure on a year-to-year basis. Courts generally recognize the distinction between claims-made and occurrence-based policies—for example, strictly enforcing notice provisions of a D&O policy, but applying a “notice-prejudice” rule to occurrence-based/general liability policies.

**D. Defense Obligations**

Typically, D&O policies are written as indemnity, rather than liability, policies. Consequently, the insurer is not obligated to indemnify or reimburse the insured for covered loss until the loss is actually sustained. Some early policies provided that no benefits (including defense costs) were payable under the D&O policy until the conclusion of the case. On the other hand, liability policies typically require the insurer to pay, on behalf of the insured, all loss which the insured is obligated to pay.

Defense costs are included within the policy definition of “loss,” and the payment of defense costs operates to reduce the policy limit of liability in a corresponding amount. Some policies may provide that defense costs are “outside” the limit of liability.

The D&O policy typically does not contain a duty to defend; rather, it is the insureds’ duty to defend claims. Under state law, a D&O insurer may be entitled to allocate defense costs and any settlement or judgment among covered and noncovered claims. But the right to allocate defense costs may arise only at the end of the case. In contrast, when an insurer has a duty to defend, it is typically required to defend the entire claim, as long as at least one theory of liability presents the potential for coverage under the policy.

**E. Typical Exclusions**

D&O policies may exclude coverage for specific categories of claims. Here are some examples.

**Breach of Contract**

Coverage may be excluded for claims arising from breach of an express, written contract.

**Bodily Injury, Personal Injury, or Property Damage**

Most D&O policies exclude claims arising from bodily injury, sickness, disease, death of any person, or for damages to or destruction of any tangible property, including loss of use thereof. Many policies also exclude claims for emotional distress, or for personal injury, including libel, slander, and defamation. If Employment Practices Liability Coverage is afforded, policies typically will eliminate the exclusion for emotional distress.
Dishonest, Fraudulent, or Criminal Acts
D&O policies are intended to cover negligent or reckless conduct; not intentional, fraudulent, or criminal acts. Policies typically exclude claims arising from, brought about, or contributed to by the dishonest, fraudulent, or criminal acts of the insureds. More recent policies tend to require a judgment or other final adjudication adverse to the insured(s) establishing that such acts occurred. The acts of one director or officer will not be imputed to other directors or officers, although an individual’s wrongful conduct might be imputed to the corporate entity.

Personal Profit of the Directors and Officers
D&O policies typically exclude claims based on or attributable to the D&Os gaining any personal profit or advantage to which they were not legally entitled. Case law prohibiting indemnification of restitution awards or orders of disgorgement parallel the intent behind this exclusion.

ERISA
Most D&O policies exclude claims for violation of the Employee Retirement Income Security Act of 1974 (ERISA) or similar provisions of any federal, state, or local statutory law or common law.

Insured v. Insured
D&O policies were never intended to provide a source of recovery for one insured suing another insured. Policies now expressly exclude claims brought by the corporation, or by one or more past, present, or future directors or officers, against other D&Os (or in some cases against the corporation). Issues arise when a successor to the corporate entity (e.g., a bankruptcy trustee or a receiver) brings claims against the D&Os.

Other Insurance
The D&O policy is designated to be excess of other insurance and will not provide coverage until the limits of any other primary insurance are exhausted. Where two policies both purport to provide excess coverage, the Other Insurance provisions of the policy may be compared to determine the extent of coverage under each policy. Mutually repugnant Other Insurance clauses may result in a determination that the policies afford concurrent coverage, and the insurers may be obligated to pay loss in equal shares or in proportion to the respective policy limits.

Pollution
D&O policies exclude claims based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving actual or alleged seepage, pollution, or contamination of any kind. These exclusions may not bar coverage for indirect losses that follow the disclosure of a corporate obligation to remedy environmental damage. A corporation also may face a derivative claim for loss to the corporation for significant environmental payouts allegedly required due to mismanagement or negligence.
F. Policy Limits and Retentions

D&O policies are subject to an aggregate limit of liability for the policy period (now usually twelve months). They also may be subject to a per-claim limit of liability. Self-insured retentions or deductibles tend to be high for corporate reimbursement coverage, whereas there typically is no deductible or retention applicable to individual D&O coverage (where the corporation is insolvent and cannot indemnify its D&Os).

Multiple claims arising out of, relating to, or involving the same facts or events, may be deemed to constitute a single claim, first made at the time the earliest claim was made. Related claims would be subject to a single per-claim limit and a single retention.