

# INDEMNIFICATION AND D&O INSURANCE

## The Basics

It is a basic fact that individuals serving as corporate directors and officers face a significant litigation exposure. Claims are regularly brought against corporate officials on a wide variety of legal theories, including, for example, allegations of breach of fiduciary duty or of securities law violations. These lawsuits are expensive to defend and they potentially expose the individual to significant personal liability.

Companies typically protect their executives from these legal expenses and liability exposures through *indemnification* and *insurance*.

## INDEMNIFICATION

Corporate officials' front line of liability protection is indemnification. This statutorily authorized protection is usually embodied in corporate documents such as articles of incorporation or by-laws, and generally encompasses the rights to both advancement of defense expenses and indemnification.

Corporate indemnification represents important protection for company officials, even for those at companies that purchase and maintain significant levels of Directors and Officers Liability (D&O) insurance. D&O insurance is subject to limits of liability, whereas indemnification is theoretically unlimited (although, of course, practically limited by the indemnifying company's financial resources). Indemnification is often very broad, often extending "to the maximum extent permitted by law", whereas D&O insurance policies contain numerous exclusions and conditions. In

addition, D&O insurance must be renewed each year, with possible changes in terms and conditions and subject to the cyclical nature of the insurance industry. Indemnification rights are much less likely to be changed, particularly for corporate officials who negotiate their own indemnification contracts.

The company's indemnification provisions specify the procedures individuals must follow in order to obtain indemnification. It is worth considering that indemnification questions often arise at a time of corporate turbulence, which may complicate an individual's efforts to obtain indemnification or advancement. A separate written indemnification provision can not only provide much greater procedural specificity, but it can also provide certain protections against wrongful withholding of indemnification, by providing presumptions in favor of indemnification and providing for "fees on fees" (that is, fees incurred in order to enforce rights to advancement or indemnification).

Although corporate indemnification is broad, it is not unlimited. There are times when a corporation may not indemnify an individual—for example, there generally are limitations on a corporation’s ability to indemnify individuals found liable in shareholders’ derivative suits. In addition, insolvency may prevent a company from honoring its indemnification obligations.

## D&O INSURANCE

D&O insurance provides protection for company officials when corporate indemnification is not available, whether due to insolvency or legal prohibition. D&O insurance also provides a mechanism for corporations to be reimbursed when they do indemnify their executives.

The coverage provision through which the D&O policy provides individuals with insurance protection when indemnification is not available is commonly referred to as Side A coverage. The D&O insurance policy’s provision for reimbursement of a company’s indemnification obligations is referred to as Side B coverage.

In more recent years, many D&O insurance policies have also incorporated a Side C coverage as well, which provides insurance protection for the corporate entity’s own liability exposures. In D&O insurance policies for public companies, this Side C protection is usually limited to the company’s liabilities for claims by its security holders.

Coverage B and C essentially operate as balance sheet protection for the company. Coverage B also provides a way for companies to contractually transfer their indemnification obligations to the insurer (subject of course to all of the policy’s terms and conditions).

Coverage A is essentially catastrophe protection for the individual executives. It provides a way to ensure that litigation protection is still available to them even if the company is financially unable to indemnify them or legally prohibited from doing so.

D&O insurance policies are generally built to complement other types of insurance that most companies carry. For example, D&O policies will typically exclude coverage for loss arising from bodily injury or property damage, because those exposures are addressed in the company’s general liability and property insurance policies. The D&O policy, by contrast to these other types of coverage, protects the

insured persons from economic loss arising from claims made against the insured persons for wrongful acts in their insured capacities.

Many companies find the amount of insurance available in a single policy of D&O insurance to be insufficient to provide adequate protection. As such, they purchase additional limits of liability through excess D&O insurance policies as part of a tower of insurance arranged in various layers.

One of the most important functions of D&O insurance is to protect the individuals when the company has become insolvent and unable to honor its indemnification obligations. This protection is afforded under Side A, as discussed above. Because of the critical importance of this insurance protection, some companies choose to buy additional amounts of insurance providing additional limits of liability just for this Side A coverage, in the form of Excess Side A insurance.

In the current marketplace, this Excess Side A insurance often provides certain additional insurance protection in the form of coverages whereby the Excess Side A insurance will “drop down” and provide first dollar protections. These additional coverages are in the form of “Difference in Condition” (or “DIC”) protection, and would apply, for example, in the event an underlying D&O insurance carrier is insolvent or if the underlying policy is rescinded.

There is no standard D&O insurance policy. Each D&O insurance carrier has forms that differ from their competitors’, and most policies are generally the subject of extensive negotiations. 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.

### CONTACT US

**Conner Strong & Buckelew**  
connerstrong.com | 1-877-861-3220