

# D&O INSURANCE

## Policy Exclusions

As a preliminary matter, it is important to note that while generalizations are possible about the kinds of exclusions that may appear in “most” or “many” policies, there are always exceptions. For example, one type of D&O policy, the so-called Excess Side A/DIC policy, often has fewer exclusions than the traditional D&O policies. In addition, more recently introduced D&O insurance policies may have different or narrower exclusions than are found in the typical policy. Any attempt to try to identify all of these exclusions and exceptions would be far beyond the scope of this article. For purposes of this introductory overview, we have limited our observations to exclusions found in traditional D&O insurance policies.

### EXCLUSIONS TO DEFINE THE POLICY’S RELATION TO OTHER POLICIES

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In order to avoid overlapping policies or duplicate coverages, most D&O policies contain exclusions providing that coverage is precluded for matters that have been reported or the subject of notice under other policies. Consistent with the claims-made nature of D&O policies, many policies also contain exclusions precluding coverage for litigation that was pending prior to the policy’s inception.

### EXCLUSIONS TO COORDINATE THE POLICY WITH COVERAGE AFFORDED BY OTHER TYPES OF INSURANCE

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D&O insurance policies are built with the presumption that they are just part of the policyholder’s overall program of insurance. With that in mind, most D&O policies contain exclusions to preclude coverage for claims that are typically covered by other types of insurance. Thus, most policies contain exclusions for loss from claims arising from bodily injury or property damage, as those hazards are typically insured under Commercial General Liability Insurance (CGL) policies. Similarly, most D&O policies exclude coverage for claims under ERISA and similar laws, as those claims would be typically covered under Fiduciary Liability Insurance policies.

## CATASTROPHIC HAZARDS

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Many policies include separate exclusions for loss arising from catastrophic hazards, such as nuclear events, environmental damage and war. Some of these exclusions, particularly the environmental damage exclusion, will often have coverage carve-backs for shareholder claims or for loss for which the company is unable to indemnify individual directors and officers. In addition, in the wake of the events of September 11, 2001, and in compliance with the Terrorism Risk Insurance Act (TRIA), many policies will also contain specific provisions relating to acts of terrorism.

## CONDUCT EXCLUSIONS

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Most D&O policies contain one or more exclusions which eliminate coverage for certain types of conduct. The conduct exclusions typically preclude coverage for two categories of conduct: first, for loss relating to fraudulent or criminal misconduct; and second, for loss relating to illegal profits or remuneration to which the insured was not legally entitled.

These exclusions can often have subtle wording differences that can significantly affect the availability of coverage. The most important wording variant relates to the trigger of the exclusion. In recent times, these provisions usually require an “adjudication” that the precluded conduct has actually occurred in order for the exclusion to be triggered. Different variations of the adjudication requirement may require the adjudication to take place in the action underlying the claim, while other exclusions may allow the determination to be made in a separate proceeding (such as a declaratory judgment proceeding).

Another important aspect of these exclusions are the accompanying provisions defining when one insured person’s conduct may be attributed to another person or to the insured entity.

## INSURED VS. INSURED EXCLUSION

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Most D&O policies have exclusions precluding claims brought by one insured against another insured, in order to restrict coverage for collusive claims and for infighting among senior corporate officials. The Insured vs. Insured

exclusion typically includes numerous exceptions (or “carve-backs” as they are usually called). The exceptions preserve coverage for derivative claims, cross claims, certain employment practices claims, and claims brought by bankruptcy trustees.

The Insured vs. Insured exclusion (often referred to as the I v. I exclusion) has evolved over time, and so there are many variants both to the exclusion and to the carve-backs. The Insured vs. Insured exclusion continues to be heavily litigated and is often at the heart of many coverage disputes. For example, Insured vs. Insured disputes can often arise in the context of corporate bankruptcy. More recently, whistleblower provisions in the Sarbanes-Oxley Act and the Dodd-Frank Act have also potentially raised Insured vs. Insured concerns (if the whistle blower is also an insured person).

## PARTICULAR CIRCUMSTANCES

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In the course of the insurance acquisition process, it sometimes happens that the insurance underwriter will identify a specific circumstance or event that represents a risk the underwriter is unwilling to accept. In that event, the underwriter will sometimes insist on an exclusion precluding coverage for the event or circumstance. While these kinds of specific event (or “laser” exclusions as they are sometimes called) are not uncommon, the typical insurance buyer that has an alternative will try to acquire a policy without the event exclusion.

## PRIVATE COMPANY D&O INSURANCE POLICY EXCLUSIONS

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The entity coverage available in a private company D&O insurance policy is quite a bit broader than the entity coverage in a public company D&O policy. In a public company policy, the entity coverage extends only to securities claims. The entity coverage available under a private company policy is not so restrictive, and in fact is quite comprehensive.

In order to protect themselves from the breadth of claims that otherwise might come within the entity coverage, many private company D&O insurers will include a number of exclusions applicable solely to the entity coverage. Some examples of entity coverage exclusions include the contract

exclusion, an exclusion precluding coverage for intellectual property claims, and an exclusion for antitrust and other competition-related claims.

The antitrust or competition exclusion is not found in all private company D&O policies. There are a very limited number of insurers who insist on retaining this exclusion or at most allowing only defense cost coverage.

Since private company D&O insurers do not want to include the risks associated with public securities trading, most private company policies contain exclusions relating to public securities offerings and trading. It is important for these exclusions to be worded appropriately so that they do not preclude coverage for activities that might take place in advance of a planned public offering. If the planned offering does not go forward, the private company policy will have to respond to any claims, so it is important that the wording of the exclusion contemplates that possibility.

## MISCELLANEOUS AND ANACHRONISTIC EXCLUSIONS

There are many other kinds of exclusions out there in the insurance marketplace, some of them quite unusual. Among other exclusions that sometimes appear is the so-called “bump up” exclusion, precluding coverage for additional amounts paid to investors claiming inadequate consideration in a corporate buy out situation.

There are a host of other exclusions that have been largely phased out but for the exception of a few carriers. An example of this kind of exclusion is the “failure to maintain insurance” exclusion (or FTMI exclusion, as it sometimes is called), precluding coverage for claims against corporate officials based on their negligent failure to obtain or maintain adequate insurance.

Another example of this type of exclusion is the old “Commissions” exclusion. The commissions exclusion, as typically worded, precludes coverage for loss incurred in connection with any claim “alleging, arising out of, based upon or attributable to payments, commissions, gratuities, benefits or any other factors to or for the benefit of an agent or employee of any foreign government.”

This exclusion was instituted after the Foreign Corrupt Practices Act was enacted in the late 70s. The exclusion has largely fallen into disuse since that time, although you still see

it on some policies from time to time. In an era of heightened FCPA enforcement activity, the Commissions exclusion is highly undesirable from the policyholder’s perspective.

D&O insurance policies for companies in the financial sector sometimes contain exclusions particularly relevant to claims and exposures associated with the companies’ specific activities. An example of this kind of exclusion is the so-called “regulatory exclusion” sometimes found on policies issued to commercial banks. This exclusion became relatively rare in the mid-90s and until recently, but as the number of failed banks began to rise a couple of years ago, the exclusion began to reappear in at least some commercial banks’ D&O insurance policies.

## A FINAL NOTE ABOUT POLICY WORDING

One final note is that language accompanying the exclusions can often be critically important. Some exclusions are preceded by all-encompassing omnibus language, precluding all loss “based upon, arising out of, or any way relating to” the excluded conduct or matter. In other instances, the exclusion is preceded only by the more limited “for” preamble. The broader preamble can substantially expand an exclusion’s preclusive effect, and accordingly, it is critically important to consider not only what exclusions a policy contains, but also how the exclusions are worded and what terms and conditions accompany the exclusions.

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

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