



SIDE A D&O IS IT A GOOD BUY?

December 9, 2008

There appears to be confusion among insurance buyers as to the potential benefits of purchasing “Side A only” Directors and Officers Liability Insurance (D&O). As a matter of reference, Side A coverage protects against “wrongful acts” committed in the capacity of directors or officers that cannot be indemnified due to law, statute, company refusal or because the company is simply not able to indemnify. From a broad brush basis, “wrongful acts” are generally defined to include “alleged or committed errors, misstatements, omissions, neglect or breach of duty” by insured persons in their capacity as a directors or officers.

Even though the standard D&O policies include Side A coverage, there are good reasons why an additional policy is a worthwhile purchase. But first, let’s outline available coverage and potential exposures that are addressed by “Side A only” policies.

Available Coverage Under Side A Only Policies

There are a number of insurers that offer Side A only coverage. However, our intent is not to discuss individual insurers but provide highlights of available coverage.

The preferred Side A policy should include the following provisions:

- Non-Rescindable and Non-Cancelable— the policy cannot be rescinded for any reason other than non-payment once it is in force. Standard policies as a rule are very difficult to rescind. They have provisions to void coverage for insured persons that provided untruthful acts in the application or support documents such as company SEC filings.
- Full Severability - Knowledge possessed by any insured cannot be imputed to any other person. Standard policies may have the capabilities to provide similar protection. However, they usually do not nor are they as liberal or as lucid in the intent as the preferred Side A policy.



SIDE A D&O - IS IT A GOOD BUY? CONTINUED

- No Presumptive Indemnification Considerations—Insurers of the standard D&O market usually require that the employer indemnify the D&O to “the fullest extent permitted by law.” A preferred Side A policy would not incorporate this section. Hence, coverage will apply even if the company is capable of but refuses to indemnify. Once the insurer expends funds for the insured person, they may subrogate against the employer; but the D&O should be covered under the preferred policy with no exposure to a deductible.
- Pollution Exclusion—The preferred Side A policy should be responsive for any type of pollution related claim that alleges “wrongful acts.” As a matter of reference, some standard policies include “for” wording which can be interpreted to cover D&Os for claims pertaining to bodily injury or property damage as long as the allegation fits the “wrongful act” definition. If coverage is triggered it would not be for the direct loss due to bodily injury or property damage but for the event’s impact to the value of the corporation. Even if “for” wording is available, it is not a guarantee. Jurisdictions will have a say on the issue of insurability. But as previously mentioned, from a Side A coverage standpoint, this is a moot point.
- No ERISA Exclusion—this is a standard exclusion in D&O Liability policies. It excludes coverage for claims of breach of fiduciary duty to ERISA. There is no such limitation under the preferred Side A policy. A word of caution is that the broadened coverage under the Side A policy may unnecessarily dilute the Side A limit for D&Os, if the company maintains a fiduciary policy with proper limits. In our opinion, this is still a desirable coverage since not all D&Os are fiduciaries of ERISA type programs but may be fiduciaries in the delegation of that responsibility.
- Insured vs. Insured Exclusion—very narrow and does not apply to claims by bankruptcy trustees, whistleblowers, or to claims outside the U.S. or Canada. Standard policies can be modified to come close to or mirror these changes. But it is reassuring to have a policy in place which is specifically designed to protect the interests of the D&Os.
- Broad Definition of Loss—usual wording includes but is not limited to damages (compensatory, exemplary, punitive, multiple damages, arbitration, and mediation proceedings) and “most favorable” venue to cover punitive damages. This definition is similar to what can be provided by standard policies.
- Conduct Exclusion - deliberate fraud, deliberate criminal acts and unlawful gain of personal profit will have at least defense costs paid until final adjudication. Even if final adjudication rules against the D&O, under the preferred policy, defense costs coverage will apply.
- Coverage can be structured to include Outside Directorship Liability if it is under the direction of the Named Insured. In respect to private companies and “not for profit” outside directorship, automatic coverage can be provided.



SIDE A D&O - IS IT A GOOD BUY? CONTINUED

- If Side A Coverage is purchased in excess of a standard D&O policy, then Excess DIC Side A Coverage proposed. This would allow the policy to drop down when the standard policy does not afford coverage and the alleged acts are not indemnifiable. If there is more than one layer of Excess DIC Side A coverage, the lead Side A policy should be the policy that the other Side A policies follow form of, not the lead standard policy. This would avoid gaps in coverage and limits.

The aforementioned represent key coverages available under preferred Side A policies. Additional enhancements are available and the buyer should make a point to learn each insurer's strengths and weaknesses.

Actions That Can Trigger Side A Coverage

It is recognized that the preponderance of D&O claims will trigger Side B (Corporate Reimbursement) and Side C (Entity Coverage). However, Side A can be triggered in a number of ways. Examples are noted below:

- Allegations of fraud under the Federal Securities law, Racketeer Influence and Conduct Organization Act (RICO), and certain antitrust violations are examples of claims that are considered to be against public policy and/or may have statutory limitations; indemnification for claims alleging the aforementioned is usually not permitted.
- Derivative suits are filed on behalf of the corporation by one or more stockholders alleging financial loss due to the corporation's wrongful acts by the D&Os. Any recovery in derivative suits inures back to the corporation.
- A board may refuse to indemnify a director or officer for the following reasons:
 - ◇ Difference between the Board and a position taken by a director or officer which questions conduct of loyalty or good faith . It may be the Board's opinion that the director or officer did not act in good faith and his or her conduct was not in the best interest of the company. Under such circumstances, state laws will probably not allow indemnification.
 - ◇ Near Insolvency may make the Board overly cautious in fear of a breach of fiduciary duty to creditors; or if bankruptcy occurs to a bankruptcy trustee.

The aforementioned are the more common types of exposure that will trigger Side A. There are more and the list will probably continue to grow.



SIDE A D&O - IS IT A GOOD BUY? CONTINUED

Conclusion

The purchase of a freestanding “Side A only” policy is a worthwhile endeavor for the following reasons:

- This coverage is totally dedicated to the directors and officers. No one can touch this policy—The entity has no right to the policy and the bankruptcy court should not play a factor. This, along with the fact that it protects the directors and officers personal assets, in our opinion, are the two most significant reason to purchase this type of policy.
- If there is a non-indemnifiable “wrongful act,” Side A of a standard D&O policy may indeed respond. But what if its limits are eroded? Then one’s personal fortune will be at risk. Do you really wish to risk all your personal assets that represent all of yours and your family’s years of hard work when a policy can be purchased to greatly mitigate this exposure?
- If a standard D&O policy is purchased as a primary policy, the Side A policy will provide additional limits which will be dedicated solely for the benefit of the D&Os.
- Broader coverage and hence better protection of D&Os’ personal assets for certain exposures that are not indemnifiable and coverage is not available in standard D&O policies.



Bottom line, purchasing a broad “Side A only” policy maximizes protection for directors and officers to help ensure that their personal assets are not at risk. In our opinion, this is a very good and desirable objective.

*Louis Garbis
President*

