



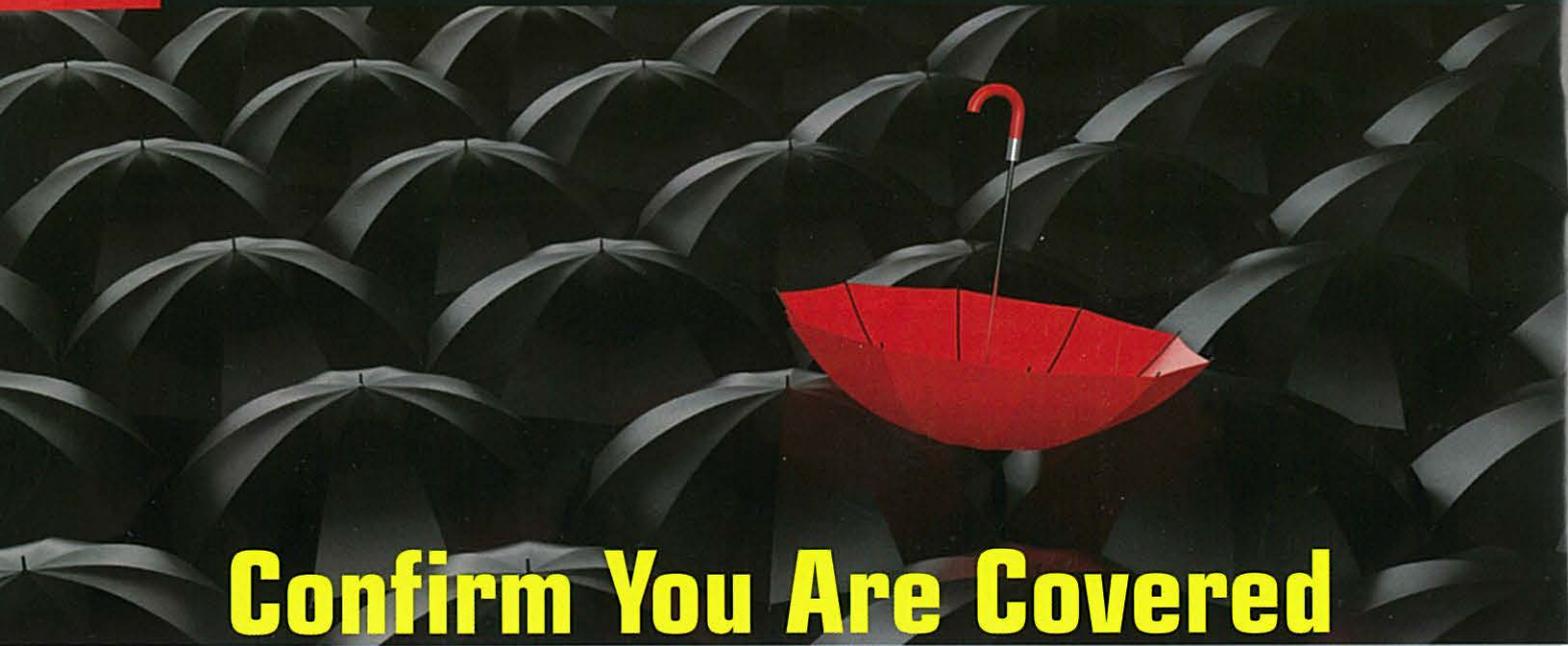
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# Confirm You Are Covered

The importance of Directors and Officers liability insurance in today's litigious environment

**C**hief financial officers and other executives sometimes face personal exposure as a result of the corporate leadership roles they hold. Plaintiffs often sue not only the company, but also the company's leaders, including its CFO.

While not all suits against companies and their executives succeed, executives still face the possibility of an unfavorable judgment. Even meritless suits accusing CFOs of wrongdoing or responsibility for claimed business losses have to be defended, and such defenses are rarely inexpensive.

CFOs who are personally sued face three general options for their defense<sup>1</sup> and indemnity<sup>2</sup>:

- 1 Defend themselves at their cost
- 2 Obtain defense and indemnity from the company
- 3 Receive defense and indemnity through an insurance company

## Why You Are at Risk

Typical suits against CFOs include numerous causes of action under both civil and criminal law. Shareholder suits alleging breach of fiduciary duty or theft of corporate opportunities are perhaps the most common. Creditors, customers, regulators, and competitors often bring suits against companies and their executives under a variety of causes of action. Executives can also face claims for alleged negligent supervision of subordinates. While the above list is not intended to be exhaustive, it is intended to drive home the point that there are a lot of risks to you by virtue of the position you hold. Many corporations recognize this risk and, in their certificates of incorporation or other governing documents, provide that the company must defend and indemnify its officers and directors to the fullest extent allowed under the law. If your company has such a provision, and the assets and will to defend and indemnify you, then

you may be protected. For those of you who are not protected by your company, then Directors and Officers coverage may be just what you need.

## Directors and Officers Insurance Explained

Directors and Officers (D&O) insurance is typically purchased by the company for the benefit of its executives. It serves to attract key personnel to the company by assuring them that their personal wealth is not at risk by virtue of their employment and position. D&O insurance, like all other insurance, contains an "insuring clause" that defines the scope of the insurance, i.e., what risk is insured. For instance, a typical insuring clause might agree to pay on behalf of the insured any "loss" because of a "claim" made against him or her for any "actual or alleged error or misstatement or misleading statement or an act or omission or neglect or breach of duty."

<sup>1</sup> "Defense" pertains to the expense of resisting the lawsuit. Typically the main component of defense costs are legal fees and costs, expert fees, and other related expenses.

<sup>2</sup> "Indemnity" pertains to the risk of a judgment in favor of the plaintiff and against the executive.



Closely related to the insuring clause are the “exclusions,” i.e., specific conduct for which insurance is not provided. The most common exclusion would be for certain intentional and criminal acts. It should not be surprising that someone who literally steals a briefcase full of company assets should not thereafter expect his conduct to be insured.

There are different types of D&O insurance available, and these types generally play off whether the company itself offers the executive some form of defense and indemnification. For example, if a corporation provides defense and indemnification to its executives, then the company might still purchase D&O coverage so that its expenditures on behalf of the executive are reimbursed. For instances where the company does not provide defense and indemnity, then the company might purchase D&O coverage to directly protect its executives. Some executives even purchase D&O coverage for themselves if their employers refuse to do so (such as if their employer believes as a matter of policy that its executives must be responsible for their own actions and therefore cannot feel invulnerable to the consequences of those actions). There is also a form of D&O coverage that provides coverage to the corporation itself for certain securities claims.

### Key Concepts to Keep in Mind

Buying insurance can be challenging, and we encourage you to consult with your insurance broker to obtain professional advice about the coverage in place and any potential gaps in coverage. There are, however, several important issues for you to consider:

- D&O coverage is not just for large publicly traded companies. Even CFOs at smaller

or privately owned companies can face suits.

- You should not assume that your company’s general liability policy or umbrella policy will protect you from suits directed at the company’s management. Many executives make the mistake of assuming they are protected by general liability policies or umbrella policies. This is typically not the case.

- D&O policies may or may not provide some protection against employment practices litigation (EPL); you should consult your insurance broker to confirm that you have adequate EPL coverage.

- Some D&O policies permit you or your employer to select your own counsel. The outcome of a case could be shaped by the quality and skill of your counsel and

it may be worth it to you to obtain either the right to select counsel or the right to at least be involved in such selection. Not all attorneys are created equal and not all have the requisite knowledge of your company’s business to quickly muster an effective defense.

- Some D&O policies require your consent to a resolution of a case and some do not. This could be significant both to your employer and you, particularly if you disagree with the carrier’s decision to settle a case.

- If the D&O policy is a “claims-made” policy — that is, it insures against claims made during the policy period even if the claim pertains to events prior to the policy period — then consider whether a “tail” or “extended reporting period” is available for claims made after the policy ends. This issue is particularly important in the event that coverage is discontinued for any reason (such as when the company ceases operations) and its executives want to continue to receive insurance for claims.

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- Is the cost of defense included within the limit of the policy or not? If you have a D&O policy with a \$1 million limit but with the costs of defense included in that limit, then a portion of that \$1 million limit will be consumed by attorneys’ fees, costs, and expert fees, meaning you won’t really have a million dollars available to cover settlement or adjudication of the claim.

- Some policy terms are negotiable, so don’t assume a carrier’s proposed policy need be accepted without negotiation. Since policies contain scores of terms, you should have an experienced attorney or broker negotiate the best ones for you.

### You Might Have to Sue for Coverage

Sometimes executives facing suit, who believe they should be protected by their employer or D&O carrier or both, are disappointed when one or both refuse. In such circumstances the executive must consider, with the appropriate advice of counsel, whether claims should be brought against either or both companies. There are numerous published opinions dealing with these issues. In general, if the court concludes that the lawsuit against the executive pleads claims within the scope of the risks for which defense and indemnity were tendered, then the court will likely require that defense be afforded, and possibly indemnification too.

CFOs face a variety of risks flowing from their responsibilities. While all hope to avoid being a defendant in a lawsuit, in today’s litigious environment, CFOs increasingly find themselves hauled into court. D&O insurance can offer CFOs facing claims the protection they need to safeguard their personal assets. ❖

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