



Corporate Exposure: Directors and Officers Liability

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The scope and number of liability cases held against directors and officers of corporations continue to increase at an alarming pace. A recent survey showed 50 percent of all outside directors of *Fortune* 1000 firms have been the target of lawsuits solely because of their board activities. Consequently, nine of every ten board members believe a critical issue when recruiting new board members is whether the company has adequate directors and officers liability limits of coverage. Liability lawsuits against directors and officers have become so commonplace that even churches and country clubs have begun carrying coverage for their board members. Indeed, many boards no longer prepare written agendas in advance of meetings as a means of eliminating potential paper trails.

"Capacity" the Key

The purpose of a directors and officers (D & O) liability insurance policy is to cover those individuals from any liability incurred due to any acts or omissions while performing in their recognized capacity within the organization. The key word is "capacity." A number of claims have been brought against officers and directors for activities that were *not* within their capacity.

Defining "capacity" can get complicated. For example, a director or officer who promises an employee a promotion can be held liable if no offer is made. The D & O policy may not respond because the individual was not acting in any official capacity as a board member but rather overextended himself or herself by getting involved in a human resources issue. Policies also exclude more serious acts such as fraud, dishonesty, libel, and slander.

It is important to note the D & O policy covers only the directors and of-

ficers, *not* the corporation should the company be held liable. When both are involved, judges and juries are often asked to proportion liability percentage between the directors or officers and the company. These "special findings" have become commonplace in courtrooms today as the need to establish liability percentages increases.

Contract Format

No standard form or policy contract exists, but in general a D & O policy has two separate sections. The first

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section details how the policy will pay liability claims for wrongful acts on behalf of any director or officer of the named corporation. The second section of the policy details how it will respond and pay on behalf of the corporation any sums required as a reimbursement or indemnification for the director or officer. To get board members to sit for a company, the corporation often has to indemnify members for any expense they may become liable for while performing in the capacity of board member. This section of the policy will reimburse the corporation for those expenses that have been incurred to satisfy this indemnification arrangement with its board members. The items covered typically do not include damages/awards but charges or expenses incurred in the defense of a suit, action, or appeal of a judgment.

The policies normally do not contain a "duty to defend" provision like other policies. Rather, they have a "duty to pay on behalf of" provision. This means the director or officer can often select his or her own defense counsel (after receiving carrier approval) and will be reimbursed by the policy for these fees. Usually, in-house counsel is not approved by the carrier because there may be some conflict with them representing both the directors' and officers' liability actions as well as the company's. Claims are usually made against both directors/officers and the company they represent. Most D & O policies are issued in 12-month contracts, but the insured can purchase an "extended discovery period" for a fixed fee or percentage of the premium base. The extended discovery provision merely provides coverage for claims that occurred during the policy year but were reported after the policy expiration and within the agreed discovery term.

An Increasing Need

The need to maintain D & O liability will continue to increase as more courts permit verbal contracts, agreements, sexual harassment, age discrimination, and other findings to be brought against directors and officers.

In summary, the limited D & O market must be approached cautiously, and policy language and coverage issues must be carefully reviewed if corporations are to be successful in filling board positions.

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