



## Directors & Officers (D&O) Coverage Check Boxes

*All policies are NOT the same or equal. Watch for 'gotchas', coverage limits, and exclusions.*

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*Directors & Officers insurance (D&O) is liability insurance that covers the directors and officers of the company against lawsuits alleging a breach of fiduciary duty. A company pays for this coverage so executives can serve confidently as leaders of their organization without fear of personal financial loss.*

In essence, D&O is a liability insurance policy, payable either to directors and officers of a company or the company itself. The policy will reimburse settlements or defense costs that result from covered claims.

### **Who Is Directors and Officers Insurance For?**

While D&O insurance is not an absolute must-have for every single business, it should be strongly considered by businesses and organizations that could be accused of financial mismanagement.

For example, if your business owes millions to creditors, D&O insurance will help protect the leadership and company in general if it ever goes under. Many times, creditors will want to blame the company's directors and officers for the business's inability to pay them back, which is a situation in which D&O insurance would come in very handy.

Also, if a company is looking to attract top-tier executives and leadership to the organization, getting D&O insurance is a good start for that process because a vast majority of top executives will not even consider joining a company that lacks this type of coverage.

Smaller, private companies and startups are often under the incorrect impression that they do not need D&O insurance, believing that their chances of getting hit with a claim are relatively small, but that simply isn't true.

In fact, a 2016 survey performed by Chubb shows that more than 25 percent of private companies experienced a claim over a three-year period and the ones that did not buy D&O insurance reported an average loss of nearly \$400,000.

Therefore, it can be concluded that any private or public company that has a board of directors should seriously consider D&O insurance. Some of the exposures that directors and officers are most vulnerable to include regulatory actions, misrepresentation allegations, securities litigation, and breaches of fiduciary duties.

D&O insurance fills the gap that general liability and umbrella insurance do not cover when it comes to protecting company board members and executives. Nonprofits should also have it since these types of organizations are managed by a board of directors as well.

*\* The decision to purchase D&O is an individual one for each company. The owners, leadership and board of a company should carefully weigh the potential risks vs the cost of the policy. Usually, it is a decision of when, not if. When there are 'outside' shareholders, when there are more than a few employees, when a potential board director, like a VC, requests insurance, etc.; and when the company can afford the \$5,000-\$10,000 cost of a modest policy.*

## **Why Do Startups Need D&O Insurance?**

Directors & Officers insurance is the coverage that is probably most consistently connected to and mentioned when talking about startups, especially startups that have received or are about to receive venture capital funding. Why is this? It's because most venture capital and private equity firms will insist that a startup gets D&O insurance before they approve the funding round.

They do this because as investors, they will be joining the startup's board, so they are basically guaranteeing that the startup will be protecting them and their assets by having a directors & officers policy in place.

For startups, having a good D&O policy gives them the ability to pay for unanticipated litigation, which can be extremely expensive. Even if you have received funding, your startup still might not have the budget needed to handle these types of legal costs, especially if the claims are complex and take months or years to resolve.

Does that mean that if your startup doesn't have a board, then it doesn't need D&O insurance? Absolutely not.

Even if your startup is organized in a different fashion, it can still face the same types of risks that a VC-funded startup with a board of directors faces. Remember, you don't need to have a board of directors for your startup's leadership to be sued for things such as contractual disputes, breach of fiduciary duty, wrongful termination, and a failure to comply with federal and state regulations and laws.

When people hear about lawsuits being filed against company board members, they immediately think of complex schemes, wrongful acts, and criminal activities, but most claims filed against corporate leaders are related to everyday events.

Hiring and dismissing employees and working with third-party vendors or suppliers are two examples of everyday business activities that most wouldn't consider risky. However, these are the exact types of activities that result in many D&O claims.

Furthermore, there are other benefits that come with having a preferred D&O policy that aren't specifically tied to claims and being able to pay for lawsuits.

Having a D&O policy also enables you to attract and hire top talent, especially at the executive level. Top candidates will almost never accept a role at a company that doesn't have a D&O policy that protects its leadership.

Even if they believe strongly in the company and its mission, a vast majority of corporate leaders do not want to put their personal assets at risk, no matter how attractive the opportunity appears.

## **Venture Capital Firms and D&O Insurance**

As was already mentioned, VCs want your startup to have D&O insurance before committing to funding it because they want to protect their personal assets as future members of your board and leadership. However, there are other reasons behind why a majority of VCs insist on directors and officers insurance.

The protection that directors & officers insurance provides gives investors guarantees that your business is serious about its growth. D&O claims can be incredibly expensive and knowing that the startup you're investing in has coverage and will not be paying legal fees and potential settlements out of pocket shows investors that the company's leadership is serious about stability and growth.

Of course, venture capital and private equity firms not only ask the companies they invest in to buy D&O insurance, they also buy it themselves when putting together an insurance program that protects their assets.

## **Why Do You Need It?**

In the event of a claim against directors and officers, the insurance carrier will help navigate the lawsuit, negotiate settlements, and cover expenses. Ultimately, this translates into significant time and money savings.

Let's look at some of the most common types of D&O claims and the areas from which they arise:

### **Regulatory Issues**

All businesses run the risk of being fined by governmental regulatory bodies if they do not conduct their activities in a lawful manner. Directors and officers can face claims from these types of bodies related to consumer protection, workplace health and safety, taxation, environmental, securities, and corporate law.

If these regulatory bodies uncover wrongful conduct on the part of company management, legal actions against both the company and its executives can be taken.

### **Competition**

Today's business world, especially when we are talking about the world of high-growth startups, is extremely competitive, with all companies looking to find any advantage they can. This can sometimes lead to business practices that might not be entirely lawful. Your company and executives can be sued for things such as collusion, breaches of intellectual property, misappropriation of trade secrets, and a variety of other anti-competitive and possibly illegal behavior.

Remember that even if your company wins the case, these types of claims tend to be incredibly complex and long-lasting, meaning that your legal expenses can be great even if the court proves that you did nothing wrong.

## **Employee Lawsuits**

Employment-related claims are one of the most common types of D&O claims. Employees will often reach out to management if they feel that they are not being treated fairly or if they are being mistreated in any way. If the employee believes that management did not address their concerns sufficiently, there's a good chance that they will file a lawsuit against the company and its management.

Employee practices claims are usually handled by an Employment Practices Liability (EPL) insurance policy, but if the lawsuit is directed specifically at the directors and officers, a D&O policy will be needed to protect management's personal assets in the lawsuit.

That's why EPLI, D&O, and several other policies are often bundled together to create what is called a management liability insurance program that aims at specifically protecting corporate leaders and their assets from a variety of possible claims.

Common employment practices claims against directors and officers include discrimination, harassment, breach of employment contract, failure to address safety or health concerns, wrongful termination, and improper hiring processes.

## **Shareholders**

Shareholders, especially those with large stakes in the company, will often monitor and analyze every move that the company's executives make. If they believe that what executives are doing with the company doesn't have their best interests in mind, shareholders might file claims against company management.

Large amounts of money are often involved, and shareholders will do anything they can to make sure that their investment is being protected. If they are not happy with the current direction of the company, shareholders are likely to file claims against the people who they believe are responsible.

D&O insurance can also protect executives and board members in the unfortunate case of bankruptcy. The D&O policy will provide indemnification, acting as a buffer between the personal assets of the directors and officers and the legal costs spent defending litigation brought by creditors, trustees, or past investors.

## **What Does D&O Insurance Cover?**

Some of the most common lawsuits that D&O insurance can protect against are related to misuses of company funds, misrepresentations of company assets, breach of fiduciary duty, failure to comply with workplace laws, and a lack of corporate governance.

The right policy will provide coverage regardless of who is suing the directors and officers. It's important to remember that company leadership can be sued by a slew of different parties, not just investors, but also customers, vendors, and even employees.

A D&O policy contains three insuring agreements – commonly referred to as Side A, Side B, and Side C. While this might seem complicated, the three insuring agreements are simple:

**Side A:** Covers directors and officers when the company refuses to or is unable to provide indemnification. This is most seen in cases of bankruptcy.

**Side B:** Will cover companies that make the decision to indemnify their directors and officers. The D&O policy, in this case, will reimburse the company for defense and other related costs.

**Side C:** Covers the company itself. If the company is being sued for financial mismanagement, the D&O policy will provide coverage.

The coverage that a company buys will vary and depend on each company's individual business characteristics and needs.

*\* It is important to insure that the policy has all three sides, and to carefully choose the coverage and limits of each of the three. Remember, if you remember one thing from this brief it should be that D&O policies are NOT all the same.*

### **Duty to Indemnify vs. Duty to Defend**

It's important to remember when getting D&O insurance that defense costs fall within the policy limits, which means that they will erode the total limit of liability available for claims payment. Therefore, it's very important to understand whether your policy is a duty to defend or indemnity (often called non-duty to defend) policy. Both have their advantages and disadvantages.

*\* Duty to defend is important if you don't want your covered individuals to have to pay out of pocket for defense and get reimbursed later.*

An indemnity policy allows the company to choose its own legal counsel. The carrier will then reimburse what they consider to be "reasonable" defense costs. The issue here is that the company and carrier might not agree entirely on what they consider to be reasonable costs for a D&O claim.

A duty to defend policy stipulates that the insurance carrier is responsible for defending the company's D&O lawsuits, even if they are groundless. For smaller and mid-sized businesses, this is almost always preferable to non-duty to defend, because defense costs are covered, settlements are efficient, and offloading this to the carrier saves a great deal of time. Of course, the one downside is that the company will not be able to choose its own legal counsel.

### **Plus Coverage for Growth Stage Companies**

You can tailor a D&O coverage in many ways to make them fit to your company's unique requirements. Typical Enhancements Include:

- Broad coverage for non-indemnifiable ("Side A") and corporate reimbursement claims
- Separate limits provided for the D&O, EPLI, and Fiduciary coverage sections.
- Additional \$1 million limit of liability for non-indemnifiable "Side A" claims
- Fully non-rescindable policy
- Fully non-cancelable policy (except for non-payment of premium)
- Pro-rata return of premium if the insured elects to cancel.

- Full individual severability for representations and warranties made in the application as well as all the applicability of all exclusions.
- Limited individuals whose knowledge and actions impute to the insured entities' available coverage.
- The "Conduct" and "Personal Profit" exclusions are crafted with "final adjudication in any underlying action" language.
- Coverage for all employed lawyers
- Insured's discretion to settle any claim within the retention without the Insurer's prior consent.
- Outside directorship liability coverage – coverage for individuals while acting as a director and/or officer of an outside (for-profit or non-profit) entity.
- Insured's "duty to defend policy" with the option to tender any claim to the Insurer.
- No "Hammer Clause" – giving the insured full discretion on whether to continue defending or settle a lawsuit.
- The Insurer is not permitted to subrogate against any Insured.
- 100 percent coverage for defense costs spent defending both covered and uncovered matters.
- 120-day post-policy reporting window
- Extended coverage to spouses and domestic partners
- Automatic coverage for all acquisitions
- Coverage for derivative investigations costs (Derivative lawsuits give corporate shareholders a platform to bring claims, on behalf of the corporation, against the corporation's directors and officers for a wide range of alleged misconduct subject to specific procedural requirements.)

*\* Add the following to your list:*

- Coverage for outside investigations*
- First demand inspection*
- derivative*
- Books and records supplement*
- First dollar coverage*
- Internal investigation*
- Subpoenas*
- Criminal defense*
- Foreign Taxes*

### **What's Not Covered?**

One of the areas of D&O insurance that isn't entirely black and white is the question of what, if any type of behavior, the policy does not cover. When it comes to D&O insurance exclusions, they are usually negotiable and vary from policy to policy according to the company's needs.

Lawsuits between directors and officers within the company are typically not covered; this prevents collusion against the insurance company. Likewise, if a director or officer is accused of fraudulent acts, defense costs are provided until final judgment proving guilt. If the executive is found guilty of fraud, they would be required to repay all defense costs.

*\* As you can quickly see, it is very important to select an insurance agent and broker who deals with D&O policies regularly. Many agents do not, rather they simply tack on D&O coverage to whatever you are already getting without having the knowledge of exactly what is covered and what is not. As much as they may have your best*

*interest in mind, they simply do not have the knowledge to best evaluate the coverage. In particular, pay particular attention to 'exclusions.'*

## What Does D&O Insurance Cost?

Naturally, there is no one correct answer to this question. The cost of any D&O policy depends entirely on the characteristics of the company:

- Legal History (Claims)
- Assets
- Debt
- Revenue
- Industry

Generally, businesses that have been in business for longer will probably pay less for D&O insurance. A company with a long history and an experienced group of leaders on their board of directors poses a lower risk of litigation and can expect to pay less.

Also, the more assets, income, and shareholders your company has, the higher your rate will be, generally.

Financial stability is another important criterion. The lower your company's risk of bankruptcy is, the lower your Side A D&O coverage will be.

And obviously, the more coverage you need, the more you are going to have to pay. An industry estimate is that for every \$1 million you want in coverage; your company will have to pay at least an additional \$5,000 in annual premium.

For startups looking to buy Directors and Officers liability insurance (as well as EPLI and Fiduciary Liability Insurance), here's rough guidance on limits, retention, and premium when purchasing through the one-of-a-kind [Embroker Startup Package](#):

<b>Funding</b>	<b>Limits</b>	<b>Retention</b>	<b>Premium</b>
\$0 – 10M	\$1 – 2M	\$10 – 25k	\$3.5 – 6k
\$10 – 25M	\$2 – 3M	\$10 – 50k	\$5 – 10k
\$25 – 50M	\$3 – 5M	\$25 – 50k	\$7.5 – 15k
\$50 – 100M	\$5 – 8M	\$25 – 75k	\$10 – 15k
\$100 – 250M	\$8 – 10M	\$25 – 75k	\$20 – 40k

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