

What is D&O insurance?

D&O Insurance:

- Protects the personal assets of a company's directors and officers;
- Protects the company's assets;
- Provides reimbursement to the organization to indemnify directors and officers for their losses; and
- Helps the company monitor and provide defense costs associated with responding to lawsuits and investigations.

Why Should Private Companies Consider Buying D&O Liability Coverage?

- The cost of defending corporate lawsuits may exceed the net worth of most private companies;
- Judgments and settlements can be financially crippling;
- Corporate indemnification may not be available;
- Adverse shareholders and other potential claimants may exist;
- Bad business decisions are likely to be more visible due to small business environment thus attracting the attention of shareholders, regulators and other third parties;
- Business decisions made by directors and officers can quickly impact the finances and operations of a company;
- Directors and Officers work in demanding environments as they cover more corporate duties;
- Unique conflicts of interest may exist due to complexity of responsibilities; and
- Companies will have a difficult time attracting qualified individuals to their Boards without D&O coverage.

Current Business Trends Point to Purchasing D&O Coverage

- Economic uncertainty;
- Access to adequate capital;
- Keeping up with technology;
- Internet growth;
- Protecting intellectual property assets; and
- Retaining qualified workers.

What are the Sources of D&O Claims?

∞ Shareholders, Investors, Partners and Members

- Mergers / Acquisitions
- Financial performance
- Executive compensation
- Stock or other offerings
- Conflict of interest
- Bankruptcy
- Inadequate / Inaccurate disclosure
- Financial reporting

∞ Customers, Clients and Consumer groups

- Extension, refusal of credit
- Debt collection
- Deceptive trade practices
- Contract dispute
- Restraint of trade
- Dishonesty
- Cost, quality of product or service
- Lender liability

∞ Other Third Party Claims against Directors and Officers (including competitors)

- Anti-trust
- Copyright / patent infringement
- Business interference
- Competitor disputes
- Prospective company acquisition
- Company defamation
- Tax issues
- Regulatory / other government issues

Sample D&O Claims

D&O claim examples are for illustrative purposes only. They are to aid in the understanding of

the product. These examples are not intended to provide legal advice or to be relied upon in any dispute. Every claim is unique and bound by all terms, conditions, declarations, exclusions, and endorsements specific to each insurance policy.

Non-Entity Employment Practices Liability: Plaintiff agreed to help form and work for a company as its Chief Operating Officer. He alleges that his employment was terminated without cause. Further, it is alleged that the company hindered his attempt to find new employment by telling third parties that the plaintiff is prohibited from using trade secrets and intellectual property that allegedly belongs to the company. A complaint was filed against the company and a director and officer which included causes of action for breach of contract, and unfair and deceptive trade practices.

Defense costs and settlement for the individually named defendant exceeded \$180,000.

Creditor Claim: Plaintiff filed a complaint against individual directors and officers of a company alleging that it's CEO, CFO, & COO conspired to use the plaintiff's services to furnish, install and repair the company's equipment knowing that it was insolvent and was planning to file for bankruptcy protection. Causes of action included: (1) fraud, misrepresentation and non-disclosure; (2) deceptive trade practices; and (3) civil conspiracy.

Total settlement and defense of the individually named defendants exceeded \$100,000.

Class Action Complaint: Plaintiffs represent a class of non-insider stockholders who invested in the company. Plaintiffs allege that certain directors and officers failed to disclose material facts and provided them with inaccurate and misleading information. It is alleged that the materials did not disclose the high turnover of management and that the company's website had not yet been developed. The company later went bankrupt. The complaint included causes of action for: (1) common law fraud; (2) negligent misrepresentation; and (3) breach of fiduciary duties.

Settled for over \$1 million and defense costs exceeded another \$1.4 million.

Conspiracy & Negligence: A professional wrestler who competes in a wrestling circuit files a complaint against the organization - and the directors and officers - which procures the talent for individual events across the country. Plaintiff alleges that he was excused by the organization from appearing at an event due to an illness in his family. The organization allegedly deemed that he was not properly excused pursuant to its rules and was suspended for a period of over one year. Plaintiff alleges that the suspension was done in an arbitrary manner and violated his contract. Plaintiff further alleges that his suspension was done in a conspiratorial manner in order to stifle competition. The plaintiff alleges the following causes of action: (1) breach of contract; (2) negligence; (3) fraud; (4) interference with prospective economic advantage/business relations; (5) conspiracy; (6) and intentional/reckless infliction of emotional distress. Plaintiff is not an Employee as defined by the insurance policy.

The matter is currently being defended and defense costs have exceeded \$200,000.

Dispute over Inventorship: An inventor files a complaint against a research

and development company specializing in medical devices alleging that the company was founded by his former partner for the purpose of stealing his highly valuable and uniquely innovative technology. This technology was the subject of a patent application which listed the plaintiff as the sole inventor. Plaintiff's former partner, in charge of securing the patent, allegedly informed the plaintiff that he must also be listed as a co-inventor for the patent to be filed. When the plaintiff refused, his former partner withdrew the application. With the partnership subsequently liquidated and the application abandoned, the former partner immediately formed a new company and filed a new patent application virtually identical to the plaintiff's but listed the former partner as the sole inventor. In his complaint plaintiff alleges that the company and its D&O (his former partner) misappropriated technology that he developed, and utilized it to establish the research and development company. Plaintiff asserts causes of action for: (1) fraud; (2) negligent misrepresentations; (3) breach of fiduciary duty; (4) conversion; and (5) successor liability.

Defense and settlement of this matter exceeded \$1 million.

Competitor Disputes: The plaintiff files a complaint against their competitor alleging that a former employee, now working at the competition, engaged in unauthorized use of confidential and proprietary information and committed other acts of unfair competition. As a result, the plaintiff alleges it has suffered irreparable and immediate injury. In addition, the plaintiff alleges that the defendant has possession of its confidential information and intellectual property. The plaintiff asserts causes of action for: (1) misappropriation of trade secrets and confidential information; (2) violation of the Computer Fraud and Abuse Act; (3) unlawful access to stored information; and (4) unfair competition. The plaintiff seeks: (1) attachment of a computer server; (2) attachment of certain files and documents; (3) injunction – preservation; (4) injunction – proprietary information; (5) injunction – surrender of possession; (6) injunction – non-compete; (7) compensatory damages; (8) exemplary and punitive damages; and (9) attorneys' fees and costs.

Total defense costs and settlement exceeded \$350,000.

Shareholder: The plaintiff alleges that certain directors have exerted complete domination and control over the company and used the company as a vehicle for their own business purposes at the expense of the company and minority shareholders. Specifically, the plaintiff alleges that certain directors helped to renegotiate a service contract and booked all of the revenue during one quarter instead of over the three year life of the contract. The plaintiff also contends that this service contract received steep discounts and would cause other customers to request similar discounts resulting in lost revenue to the company.

The defense and settlement of this case exceeded \$500,000.

Misappropriation of Trade Secrets: A wholesale supplier and distributor of food products met with a sales representative of a new product line they were considering. The sales representative communicated that in order to develop a long-term exclusive relationship within the designated territory the wholesaler must provide her with information regarding its business operations, customers, and trade secrets. Later on, the sales representative opened her own wholesale distributorship within the same territory.

This claim is currently being defended and defense costs have exceeded \$450,000.

Breach of Investment Agreement: A company enters into an

investment agreement with a third party and agrees not to negotiate with any other entity regarding financing or a potential acquisition for a two-week period. During the exclusivity period the company engages in negotiations with another investment group. The third party alleges breach of investment agreement and intentional and negligent misrepresentation.

Total defense costs and settlement exceeded \$350,000.

Shareholder Derivative Action: A shareholder derivative action is taken against a company for breach of fiduciary duties on behalf of the directors. The plaintiffs contend that the defendants have failed to provide them with certain information, such as shareholder listings, financial data and other corporate records. They also allege that certain directors borrowed money from the company without the Board's approval and subsequently these loans were forgiven.

Total defense costs and settlement exceeded \$500,000.

Breach of Fiduciary Duty: A private company agrees to perform market research for a start-up company in the material management industry. In exchange for their services, the company allegedly agrees to pay the private company \$20,000 in cash and 5% of the privately placed issued shares in the company. The company denies that they explicitly or implicitly agreed to pay the private company in stock. The plaintiffs allege several causes of action, including breach of fiduciary duty.

Total defense costs and settlement exceeded \$800,000.

Misrepresentation/Deceptive Trade Practices: A private software company represents that it can write software for a major corporation according to the corporation's specifications; provide maintenance services for four years; and execute updates and upgrades to the software. The private company misses key delivery dates. The software fails key functionality tests and ultimately crashes and becomes inoperable. The corporation decides to withhold payments until certain milestones are met. The private software company allegedly indicates to the corporation that it needs the payments in order to remain solvent. The plaintiff alleges that the private software company represented that it could produce the software and that it was a financially stable company. The plaintiff alleges the following causes of action; misrepresentation and deceptive trade practices; and breach of covenant of good faith and fair dealing.

Total defense costs and settlement exceeded \$1,000,000.

Government Agency: The federal government sued the CEO, the President and other officers of an East Coast manufacturing company for price fixing.

After an extensive trial, the allegations were dismissed due to lack of circumstantial evidence, but the defense costs and fees incurred were in excess \$750,000.

Deceptive Trade Practices: A private company that manages and runs a major natural resource receives a claim against the company and various members of the board of directors. The plaintiff alleges that the board of directors has used their position for their own private

benefit and personal advantage, and for the benefit and advantage of their private employers. The plaintiff also alleges that the board of directors assigned a valuable contract without receiving any consideration. The plaintiff further alleges that such assignment also constitutes misappropriation of valuable assets for the benefit of private party in violation of state codes.

Total defense costs exceeded \$250,000.

Inaccurate Disclosure: A class action suit was commenced by various investors who participated in an internet startup's Private Placement that raised in excess of \$5 million to fund capital expenses, to provide working capital and to cover operating losses. An investigation made by and through counsel, primarily from corporate records, public records and documents shows that the Private Placement Memorandum contained an unaudited year end balance sheet and statement of profits and losses which were materially misleading.

Total defense costs and settlement exceeded \$500,000

Inadequate Financial Reporting: A technology company received a complaint from an investor who alleges the company improperly induced the plaintiff to issue a note payable to the company. The plaintiff specifically alleges the company made false representations and other false statements regarding the company's forecasted rate of growth and failure to disclose its tax lien. The company defaulted on the promissory note when it failed to make the required principle and interest payments. The plaintiffs issued a demand letter and filed suit against the company.

The plaintiff agreed to accept the company's offer to convert the promissory note to stock in the company, but the defense costs exceeded \$100,000.

Loan Default: A diversified sports product company received a lawsuit against the President, CEO, and Chairman of the Board for not honoring a promissory note. The plaintiff alleges that it lent \$1 million to the company. The company allegedly agreed to pay the funds back within a month pursuant to the promissory note. Despite requests for return of the money, plus interest, the company has not returned the funds to the plaintiff.

Total defense costs and settlement exceed \$250,000.

Foreclosure/Unfair Competition: A shareholder commenced a derivative action against the president of a company which develops and markets chemical compounds, after all its assets were sold. The company entered into an agreement to allow a corporation to test and evaluate its compounds. The corporation subsequently received various patents for the compounds; however, it refused to enter into a licensing agreement with the company. The plaintiff concludes that the company can assert causes of action against the corporation for breach of contract; breach of fiduciary duty; misappropriation of trade secrets; unfair competition; fraudulent concealment; and intentional misrepresentation. The plaintiff also alleges the company series B shareholders did not approve certain loans. Subsequently, after the company defaulted on the loans, the president decided to execute a foreclosure sale of the company's assets and he advised the shareholders that he is resigning. The plaintiff alleges that the President did not promptly advise the shareholders of the foreclosure sale and he breached his fiduciary duties when he failed to have the Company commence litigation against the corporation that was retained to test its compounds. The complaint is comprised of four causes of action, including: (1) negligence, (2)

breach of fiduciary duty; (3) concealment; and (4) unfair competition.

Total defense costs and settlement exceeded \$750,000.

Shareholder Claim: A Midwest domiciled home products company retained an independent research firm to evaluate its new home product. Based on a favorable review by the outside firm, the company raised in excess of \$10 million for the production and marketing of the new product. Prior to releasing the product, the company's internal evaluation team discovered, after extensive testing, that the new product did not work properly. Shareholders have brought suit against the company and the directors and officers for misrepresentation in the offering documents. The plaintiffs assert causes of action for violation of various state securities laws and the Securities and Exchange Act of 1934.

Damages alleged in the lawsuit exceed \$15 million.

Duties of Directors and Officers

Duty of Care

Directors and officers are expected to perform their duties in good faith and at a level of professionalism they reasonably believe to be in the interest of the corporation and with the care that a reasonably prudent person in a similar situation would use under similar circumstances. The duty of care is a variable benchmark dependent upon the expertise, experience and background of each director and officer.

Duty of Loyalty

The duty of loyalty prohibits directors and officers from using their positions to further or enhance their private interests and requires them to refrain from engaging in personal activities which might injure the corporation. It requires an unselfish and undivided loyalty to the corporation and demands that there be no conflict between one's self interest and that owed to the entity. Directors and officers may not realize secret profits or unfair personal gain, may not abuse corporate authority, may not compete with the corporation to its detriment, and may not transact business with the corporation unless the director or officer can demonstrate that the transaction was fair and reasonable to the corporation.

Duty of Obedience

Directors and officers are required to perform their duties in accordance with applicable statutes and the terms of the corporate charter. Directors and officers are not excused from their duties if they are unfamiliar with the laws governing their conduct. Frequently, directors and officers fail to observe traditional corporate formality, such as director and shareholder meetings may not be held, books and records not properly maintained and resolutions approving significant transactions may not be recorded.

D&O Terms and Definitions

D&O exposures and liability are not routinely understood. The understanding of common terms is an essential building block to gaining expertise.

- **Allocation:**

This refers to the process that determines which portion of loss is covered between the corporate entity and the Directors and Officers. The allocation process determines how much of the defense of costs are advanced and in the end how much of the settlement or judgment is covered.

- **Claims-made Policy:**

Coverage under the policy is triggered when the claim is made during the policy period.

- **Continuity Date:**

This is the date that a company last signed a warranty statement. It also ties back to a prior and pending litigation exclusion and a known wrongful acts exclusion in the policy forms.

- **Derivative Suit:**

An action brought by a shareholder on behalf of the corporation against the directors and & officers of the company for breach of their fiduciary duty.

- **Discovery:**

Also referred to as optional extension. The Assured may choose to elect Discovery for an additional premium usually for 12 months from the date the policy is cancelled. During this time, the company can report claims made against the directors and officers for wrongful acts committed prior to the effective date of cancellation.

- **Duty to Defend:**

The insurer appoints defense counsel and assumes the defense of a covered claim.

- **Entity Coverage:**

Extends coverage to the company (entity) for all covered claims.

- **Retroactive Date:**

Claims arising out of wrongful acts committed prior to this date are not covered under the policy. This is also referred to as the "Retro Date or prior acts exclusion".

- **Run-off:**

When the insured experiences a change in control (such as the company is sold or there is a change in ownership), the policy ceases providing ongoing acts coverage for the remainder of the policy period.