

From the desk of Jeanne M. Kerkstra, Esq., CPA

Viewpoint
The ABCs of D&O Insurance

When you are approached to be on a Board, there are two things that should leap to mind immediately—asset protection and D&O insurance.

In the last big financial blow-up, which you will recall involved Enron and WorldCom, shareholder derivative suits and the government sought to hold the Boards accountable for the failures of these huge companies.

When Enron and WorldCom went down (and the stunning collapse of Arthur Andersen from a pending company criminal indictment), it had big repercussions, including shareholders losing their investments and employees losing their jobs. However, those events now unfortunately pale with the tsunami of economic collapse that has hit the global economy.

With that said, Boards will be investigated, yet Boards will continue to have to provide oversight to the management of a company. What if you are asked to serve on a Board? First, before you join, limit your personal holdings through legitimate asset protection. Equally important, find out the specific terms of the D&O insurance for the company whose Board you are considering joining.

A typical D&O insurance policy has 3 components. Side-A coverage involves coverage when the company is not able to provide indemnification to its officers and directors, such as when there is a shareholder derivative suit (a suit brought on behalf of the company) or when the company is insolvent—an event unfortunately happening more frequently every day. Side-B coverage is for reimbursing a company when it has paid out legitimate reimbursements and advancements for D&O lawsuits. Side-C coverage comes into play when the company itself is a defendant in the claim.

It is important to note how an expensive lawsuit can use up all of the Side-A, B and C coverage before the lawsuit is over. Consequently, nowadays more directors and officers are demanding that there is, in addition to the standard D&O insurance coverage, supplemental stand-alone Side-A coverage. Also, directors and officers are challenging the notion that "two's company and three's a crowd" when it comes to insurance coverage. Because of the instability of the insurance carriers themselves, it is highly recommended that D&O insurance is obtained from several independent, non-affiliated sources. Although there may be more parties involved in negotiating a settlement, there is a higher likelihood that more of these parties will be solvent at the time settlement is trying to be reached. Also, if an insurer has less at stake, it may be more willing to discuss settlement. An important clause that should be considered in today's economic climate is the Difference in Conditions (DIC) in which the Side-A policy should drop down to fill the coverage gaps of a company's primary D&O policy in the event of the insolvency of one of the insured.

Bottom Line: Before hopping on "Board", asset protection and the terms and conditions of D&O insurance coverage should be scrutinized. No job is worth risking it all.

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