

SPECIAL REPORT

INSURED V. INSURED EXCLUSIONS IN D & O

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INTRODUCTION

All D & O insurance policies contain insured versus insured exclusions which are designed to preclude coverage for collusive acts by directors or officers in suing the corporation or LLC. However, the scope of the language of such exclusions can be much broader than this and care should be taken to analyze each D & O policy for its precise exclusionary language and to negotiate carve-backs where possible.

THE EXCLUSION

The typical insured versus insured exclusion in a D & O insurance policy reads:

“(we do not provide coverage for) Any claim brought or maintained by, at the behest, or on behalf of any ‘insured.’”

The definition of “insured” typically includes past and present directors and officers or executives. Some policies also include in-house general counsel, managers and trustees.

THE COVERAGE GAP

Given the language “present and past directors and officers” in the insured versus insured exclusion, there are major issues that can arise from a coverage standpoint.

If a minority shareholder or member of the company resigns as an officer and then sues as a shareholder for oppressive action, for example, there would be no coverage and no duty to defend in light of the referenced

exclusion. This seems at odds with the purpose of D & O policies which are designed to cover claims brought by share-holders. However, the fact that the exclusion applies to past directors and officers removes any question as to coverage, even if the wrongful act is after the resignation as an officer.

PARTIAL SOLUTIONS

Although our research revealed no insurer that would completely remove an insured versus insured exclusion on a D & O policy, there are some carve-backs that can be negotiated. For example:

1. Shareholder derivative action carve-back. If negotiated, this would nullify the affect of the insured versus insured exclusion as to claims brought in the name of the corporation on behalf of the stakeholders. This is an important exception but would require that the claim or suit be brought in the name of the company which is not always the case.
2. Whistle-blower protection act carve-back. Some insurers will agree to an exception to the insured versus insured exclusion for whistle-blower claims. Given that the federal Dodd-Frank Act provides incentives for whistle-blowers, this is a critical carve-back. Some carriers will apply this to the Federal False Claims Act. Such whistle-blowers could be officers or directors and if negotiated, this exception could save the day on a D & O claim otherwise barred by the referenced exclusion.
3. Independent and without solicitation carve-back. It is possible to negotiate an exception to the exclusion for claims made totally independently of and without the solicitation, assistance, participation or intervention of an insured. However, the definition of “insured” includes past directors and officers so this carve-back may be tenuous yet this is worth negotiating, if possible.
4. Cross claims or third party claims. At least one carrier will cover lawsuits between insureds in the form of a cross claim, third party claim or other proceeding for contribution or indemnity which is part of, and directly results from, a claim that is covered by the D & O policy.

5. Wrongful acts committed subsequent to the date such director or officer ceased to be a director or officer. Insurers that will agree to this exception usually limit such claims to two (2) years from the date of termination of status as a director or officer.
6. Bankruptcy or Insolvency. Bankruptcy trustees, receivers, a creditors committee or similar official for the insured company could bring claims against directors and officers. These actions could otherwise be excluded by the insured versus insured exclusion unless this exception is negotiated.

CONCLUSION

The insured versus insured exclusion goes a lot farther in scope than to preclude coverage for collusive actions by stakeholders seeking to obtain funds for a company. It also applies to past officers or directors which can pose a serious coverage gap where the stakeholder is also a past officer or director. Where possible, carve-backs such as those discussed in this article should be negotiated.

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