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Perspectives

DIC clause helps strengthen D&O coverage

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Without a doubt, having a good directors and officers liability program in place is a critical task for risk managers. Especially with publicly traded companies, risk managers must ensure that their directors and officers are sufficiently indemnified should they be named in a lawsuit. On top of addressing obvious fiscal concerns, companies want the very best individuals to serve as directors and officers. Having a thorough and comprehensive D&O program may be the ultimate factor in attracting a prestigious individual to serve on a company's board.

In today's business climate, directors and officers can easily find themselves without D&O coverage. When insurers first began writing D&O coverage, it was generally for the benefit of the individual directors and officers. As D&O evolved, extending coverage to the corporate entity became the norm. This tactic often left the individual directors and officers exposed, as huge settlements naming the entity consumed all of the policy's limits.

Additionally, over the last few years, we have witnessed an epidemic of corporate and financial fraud cases. The cases of Enron Corp., WorldCom Inc. and Tyco International Ltd., among others, have led to significant D&O litigation, not only casting a disparaging light on corporate executives and board members everywhere but directly leading to the increased scrutiny of America's boardrooms, manifested in the creation of the Sarbanes-Oxley Act. In the end, these cases often leave the assets of the individual directors and officers exposed, as policy limits

are consumed by litigation.

In addition, risk managers may inadvertently overlook an exclusion or policy coverage term. Woe to the risk manager who has placed D&O coverage only to find that a claim has been denied due to an exclusion in the policy. The result is a "perfect storm" of conditions barely navigable by even the most savvy risk managers. However, risk managers should consider a new alternative when placing their company's D&O coverage—a Clause 1/difference in conditions liability policy. This coverage may be perfect for the risk manager desiring the most comprehensive D&O program at the most reasonable price.

One key benefit of the Clause 1/DIC policy is a liability limit that exists solely for the benefit of the individual directors and officers. A claim involving the entity cannot erode the limit.

Another key provision of the Clause 1/DIC policy requires the policy to respond in cases in which the corporate entity cannot or will not indemnify. Does state law prevent the corporation from indemnifying? The policy would be there to respond. What if the corporate entity finds itself in financial dire straits? Or what if the corporation simply refuses to indemnify due to an acquisition, merger or some other type of change in control? The Clause 1/DIC policy exists to indemnify the directors and officers when there may be no corporate assets to do so.

Finally, what if the risk manager overlooks something in the standard D&O contract? As



an excess policy, the Clause 1/DIC policy drops down and fills gaps—hence the DIC provision—should the D&O carriers deny coverage for any reason. Also, the Clause 1/DIC policy will often provide coverage should one of the primary D&O carriers become insolvent.

Indeed, the Clause 1/DIC policy is an option that risk managers should not ignore.

Often, Clause 1/DIC policies cost less than traditional full-entity D&O because no entity securities coverage is included. Add to all of this some new features coming into the marketplace such as provisions covering fines levied under Section 308 of the Sarbanes-Oxley Act and the ability to write the coverage as primary or excess.

The result is a new product based on an old idea, one that may help round out any D&O placement. Quite a few insurers, both domestic and Bermuda-based, now are offering Clause 1/DIC policies. The premiums and coverage features vary, but a good insurance broker can help navigate the maze of price and forms. The Clause 1/DIC form does have its drawbacks: it may have onerous exclusions; it provides no coverage for the entity; and, in a highly competitive market for good D&O accounts, its coverage rates may be such that a policy for all three insuring clauses costs roughly the same as the preceding underlying layers. Regardless, the Clause 1/DIC form is an alternative worth considering.

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