THE LAWYER

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Insurance: details and the devil

18 March 2013

Get the wording of D&O policies right and avoid unpleasantness for clients when the stuff hits the fan

It would be a mistake to think that directors and officers (D&O) insurance provides a blanket indemnity. D&O policy wordings are complex and technical.

Frequently, coverage is subject to a number of exclusions, some of which may be introduced through addenda or endorsements, Many insurers look to provide coverage on the basis of their standard terms which can contain provisions that limit the scope of cover or the ability of directors to access it. Many insurers are reluctant to provide broad coverage in respect of investigations unless asked, given the potential expense involved.

This is against a backdrop of English insurance law that is often seen as being favourable to insurers. The duty of disclosure that arises on purchasing any policy can be onerous as it requires every fact material to the risk to be disclosed in pre-contractual discussions, failing which the insurer can avoid the policy - that is, tear it up and treat it as if it never existed. Also, many policies contain strict requirements on the notification of claims and potential claims. Failure to comply may jeopardise coverage.

When it comes to policy wording, the devil is in the detail. The key message for policyholders is to review and understand policy wording before they buy. A policy can be as important to the company and its directors as a financing agreement or key customer contracts, yet little attention is paid to wording until a claim arises, which is often too late. A D&O policy wording should be negotiable, particularly for those paying significant premiums. Reviewing wording and negotiating improvements at the pre-contract stage can pay off.

Equally, a transparent approach to explaining to insurers during negotiations how the disclosure process has been managed can minimise the risk of a dispute later. This risk can also be managed through negotiating language into the policy whereby insurers waive the right to avoid the policy if, say, a non-disclosure is made innocently.

Much of the difficulty surrounding approval of the retention of defence counsel and obtaining a prompt coverage opinion from insurers can also be addressed through a proactive approach at the pre-contractual stage, for example by agreeing improved conditions on claims notification and co-operation as well as a pre-approved panel of defence lawyers.

While negotiating a good D&O policy wording will go some way to providing comfort that coverage will be available and accessible reasonably quickly, it is impossible to guarantee the policy will always respond in times of need. Directors should therefore consider requesting an indemnity from the company either upfront or on a pro tern basis when a claim situation arises.

This will provide a source of funding for defence costs if cover is unavailable. Further, a corporate indemnity works in conjunction with D&O insurance in that what company pays on behalf of directors may be recoverable.

K&L Gates senior associate Frank Thompson assisted with this article