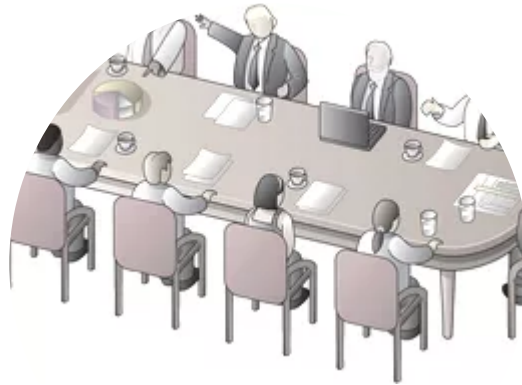




BUSINESS INSURANCE ► LIABILITY

Directors and Officers Liability Insurance

Few People Would Serve as Directors or Officers Without D&O Insurance



BY GREGORY BOOP

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Directors and officers (D&O) liability insurance protects corporate officers and directors from claims alleging they performed their duties improperly. You should consider this coverage if your company is a corporation. Lawsuits against board members and company officers can be very costly.



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Corporate Organization

A corporation is a legal entity owned by shareholders and governed by a board of directors. The directors are elected by company shareholders to oversee the company's affairs. The board appoints officers to manage the company's day-to-day operations. The officers typically include a chief executive or president, a chief financial officer, and a secretary. Some companies have additional positions, such as a chief information officer or a chief human resources officer.

Obligations and Liability



Directors and officers are [fiduciaries](#) of the corporations they serve. As such, they are obligated to demonstrate care, honesty, loyalty, and obedience when carrying out their official duties. They must act in the interest of the corporation, follow the company's bylaws, and comply with state and federal legislation.

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Directors and officers are liable to the corporation for negligent acts or errors they commit while serving the company. Acts or decisions they make may cause harm to the corporation or employees, creditors, vendors, competitors, and other third parties. Anyone who has been harmed may file a lawsuit.



In some cases, directors or officers may be held personally liable for a plaintiff's injury. This means their personal assets may be used to satisfy the plaintiff's demand for damages. Personal liability may apply if an officer or director has breached a fiduciary duty, engaged in fraud against the company, or committed a criminal act. The fear of personal liability can deter people from serving as officers or directors.

A corporation is [vicariously liable](#) for negligent acts or errors committed by directors and officers while performing their duties on the corporation's behalf. Thus, a corporation is subject to suits by third parties for injuries they have sustained as a result of acts committed by a director or officer.

Stockholders are essentially silent owners of a corporation. Because they have no say in the way the company is operated or managed, stockholders cannot be sued as a result of negligence or wrongdoing committed by officers or directors.

Acts That Can Lead To Suits

Here are examples of acts that can lead to lawsuits against directors or officers:

- Inaccurate statements made to investors, lenders, vendors or customers about the firm's current financial health
- Wrongful termination, [discrimination](#), or harassment of a current or former [employee](#)
- Mismanagement of the company's finances, which caused the value of the firm's stock to decline



- Initiation of a merger or acquisition without conducting due diligence
- Misstatements regarding the company's future financial performance
- Misappropriation of a competitor's trade secrets
- Insider trading
- Violations of securities laws
- Conflicts of interest
- Theft of the company's intellectual property
- Failure to conduct elections properly

Indemnification

To attract qualified individuals to serve as directors or officers, corporations provide indemnification. This means they reimburse directors or officers for the cost of damages and defense expenses that result from lawsuits. If indemnification were not provided, few people would choose to be officers or directors. Most states permit corporations to indemnify directors and officers except in certain circumstances. For instance, indemnification may be prohibited for derivative suits or suits resulting from criminal acts. A derivative suit is a suit filed by a shareholder on behalf of the organization against a third party.

Many states allow corporations to decide the extent to which they will provide indemnification. These decisions are often incorporated into a firm's bylaws.

Directors & Officers Insurance

Directors and officers liability (D&O) coverage is a type of [errors and omissions insurance](#). It protects directors and officers from lawsuits filed by shareholders, regulators, state investigators, or other third parties.

D&O policies cover claims seeking damages for *financial* injuries (not [bodily injury](#) or [property damage](#)) that result from an error or omission committed by a director or officer. Many D&O policies provide the following types of coverage:

- **Directors and Officers Liability.** Called Side A, this coverage protects directors' and



director or officer who has not been indemnified because the corporation is bankrupt or is barred by law from providing reimbursement.

- **Indemnification.** Called Side B coverage. It reimburses the corporation for funds it has paid to directors or officers (or on their behalf) as indemnification.
- **Corporate Liability.** Called Side C or Entity Coverage. Covers claims or suits filed directly against the corporation. Entity coverage varies in scope depending on whether the insured is a private, public or non-profit corporation. When the insured is a public corporation, this coverage usually applies to securities claims only.

D&O [policies](#) are [claims-made](#), meaning they limit coverage to claims made during the policy period. Many policies include the option to purchase an [extended reporting period](#), which covers claims reported after the policy has expired. Some policies include coverage for employment-related practices like [discrimination](#) and wrongful termination. If this coverage isn't included in the policy, the [insurer](#) may offer it under a separate [employment practices liability](#) form.

Specialized Policies

Some D&O insurers have developed policies for specific types of businesses. An example is a [Private Company D&O policy](#), which is designed for corporations whose stock is not publicly traded. Specialized policies are also available for non-profit organizations, financial institutions, healthcare companies, and educational institutions.

Article edited by [Marianne Bonner](#)

