

# Coverage traps

*Will your D&O insurer pay when you have a claim?*

BY STEPHEN J. WEISS AND THOMAS H. BENTZ JR.

**T**HE ACID TEST of a D&O insurance policy is whether it actually pays when you have a claim. Unfortunately, even if you have a policy with broad coverage terms, there is no guarantee that your insurer will actually pay losses, since even broad policies have coverage traps. We identify some of the most common traps below.

## Trap One: Notice

D&O policies are typically written on a "claims-made" basis. This means you must give notice of a claim as soon as is practicable. Failure to comply with this requirement may allow your insurer to deny coverage for an otherwise covered claim owing to late notice. Late notice is one of the most common reasons insurers deny coverage.

Insureds who report claims late tend to do so for one of two reasons: They fail to recognize that certain events constitute a claim; or, they decide not to report a claim because they assume (incorrectly) that the claim can be resolved for less than the applicable retention.

- *Recognizing Claims:* It is important to remember that a claim is not limited to a lawsuit. It can include a written demand for monetary or non-monetary damages; a civil, criminal or administrative proceeding; or even a governmental investigation. Under this definition, an angry letter from a shareholder demanding governance changes would be a claim. Failure to report it could result in a loss of coverage for that claim and any related claim as well.

- *Deciding Not to Report a Claim:* Another common mistake is failing to report a claim because you assume it will never exceed the retention of the policy. Sooner or later, a claim that everyone expected would be disposed of for a nominal amount will blow up into a

more serious situation or, worse yet, spawn a significant, related lawsuit. If you don't give notice promptly, you could lose coverage for the original suit *and* the related suit.

Given the obvious need to report a claim promptly, it is important for your company to have a well-defined system in place for identifying a claim and for-



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warding notice of the claim to the company's risk manager and, ultimately, its insurers.

## Trap Two: Selecting Defense Counsel

Most D&O policies place limits on your selection of defense counsel. For example, some policies require insureds to choose from a pre-approved list of law firms ("panel counsel"). Failure to use panel counsel could be construed as a breach of the insurance contract, which would entitle the insurer to refuse to cover any defense costs.

Avoiding this trap is easy. You simply need to select one of the many highly qualified firms on the panel counsel list for the applicable jurisdiction. If circumstances require a non-panel counsel

firm, it is best to try to negotiate an exception to the panel counsel requirement as soon as possible after a claim is made or, better yet, before a claim arises.

Policies that do not require the use of a panel counsel often present a more difficult trap to avoid: the requirement that the chosen law firm charge "reasonable" fees. It should come as no surprise that what is reasonable to an insurer frequently differs from what is reasonable to an insured. This difference of opinion can be costly if the insured is stuck paying the difference between the fees charged by defense counsel and what the insurer believes is reasonable. To avoid this problem, inform your insurer of your counsel's billing rates as soon as possible. This way, you can attempt to resolve any disagreement about rates before the company has spent a significant amount of money defending the claim.

## Trap Three: Settling Claims

Most D&O policies prohibit insureds from entering into any settlement agreement without the prior written consent of the insurer. Some policies even prohibit insureds from making a settlement offer without the insurer's consent. Insurers take these requirements very seriously, since they are potentially funding the loss. Failure to comply can result in an insurer denying coverage because it was prejudiced by an unreasonable settlement or settlement offer. To avoid this trap, you should involve insurers in all settlement negotiations.

It is also important to be very conscious of how a settlement is structured. Admitting or not admitting various facts and/or liability in a settlement may trigger an exclusion in the policy, which could give the insurer the right to deny your claim.

As the preceding discussion illustrates, you must remain mindful of the many coverage conditions of your policy throughout the *entire* life of a claim to avoid coverage traps. ■

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