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507 Maximizing Insurance Coverage

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Faculty Biographies

Heather French

Heather French is vice president and deputy general counsel at American Capital in Bethesda, MD, where she is responsible for handling litigation and labor and employment matters.

Prior to joining American Capital, Ms. French was a counsel in the labor and employment section of Akin Gump Strauss Hauer & Feld LLP in Washington, DC and McLean, VA, where her practice focused on complex litigation involving a myriad of statutory, common law and contractual claims. Ms. French also advised companies on a wide range of labor and employment compliance and training issues, assisted companies implementing reductions in force, consulted with companies on labor and employment and litigation issues involved in mergers and acquisitions, and negotiated employment contracts and severance agreements.

Ms. French received her BA, with distinction, from the University of Wisconsin-Madison and her JD from the Georgetown University Law Center, where she served as an editor of the Georgetown Journal of Legal Ethics and a member of the Georgetown Moot Court Team.

John Schryber

John Schryber is a senior litigation partner in Patton Boggs' Washington DC office, and has advised financial institutions and other major corporate policyholders with respect to sophisticated and novel insurance coverage issues. Using creative strategies, both inside and outside litigation, Mr. Schryber helps clients obtain recoveries from liability policies. He has won multiple federal appellate rulings, creating laws favorable to commercial policyholders regarding the scope of directors' and officers' coverage, trademark infringement coverage, non-recourse settlements, and the discoverability of insurers' claim files.

Recently, Mr. Schryber has devoted much of his time to advising financial institutions on recovering sub prime meltdown losses and attorney fees, a subject on which he has written and spoken at various seminars for in-house counsel both in the United States and abroad.

Maximizing Insurance Coverage in Commercial Disputes

PART ONE:

"MINING" LIABILITY INSURANCE POLICIES IN COMMERCIAL CONTRACT DISPUTES

I. When is an Uncovered "Contract-Related Claim" a Covered Tort Claim?

A. Breach of Contract/Tortious Inducement to Contract

1. Was the contract induced by any material false statements?
2. Were those misrepresentations made – i.e., was the contract signed -- by an officer or director of the corporate contracting party?
    - "[As for] an agent or officer [who] commits or participates in the commission of a tort, whether or not he acts on behalf of his principal or corporation, he is liable to third persons injured thereby." *Scribner v. O'Brien, Inc.*, 169 Conn. 389 (1975); <u>19 Am. Jur. 2d, Corporations, § 1382</u>
5. Is the individual officer who made the misrepresentation an insured under any policy insuring against liability for "misrepresentations," e.g., a D & O policy?
6. Were "out-of-pocket" or "reliance" damages sustained in reliance on the misrepresentation?

5. Does the complaint allege facts that, if proved, (a) would establish a tort claim and (b) would not trigger any "contract" exclusion?

   a. The policy's "contract" exclusion

      i. Two general types: (a) "existence *or* breach" of contract, and (b) "breach" of a contract only.

      ii. "Existence or breach" exclusion. Courts generally refuse to enforce where only "existence" (but not "breach") is implicated, as "existence" alone would vitiate an entire species of covered claims, e.g., "securities claims," which depend upon "existence" of contract selling the securities at issue. *Admiral Ins. Co. v. Briggs*, 264 F. Supp. 2d 460 (N.D. Tex. 2003).

      iii. "Breach" exclusion. *Majority*: Exclusion applies only if the claimed tort liability depends on a showing that there has been an actionable breach of a contract benefiting the claimant resulting in the same injury claimed in tort (such as, tortious interference with contract or negligent performance of contract). *Houbigant, Inc. v. Federal Ins. Co*., 374 F.3d 192, 203 (3d Cir. 2004). *Minority*: Exclusion triggered even where the facts of particular tort claim establish, *incidentally,* a breach of a contract to which the claimant is a beneficiary.

   b. Tortious inducement

      i. Avoids "breach" exclusion under either interpretation of exclusion (conduct precedes closing of contract; distinct damages)

      ii. Negligent Misrepresentation by Signing D & O

   • "Special Relationship" condition. Whether such relationship existed is issue of fact requiring consideration of: [i] whether the person making the representation held or appeared to hold unique or special expertise; [ii] whether a special relationship of trust or confidence existed between the parties; and [iii] whether the speaker was aware of the use to which the information would be put and supplied it for that purpose. *Kimmell v. Schaefer*, 89 N.Y.2d 257 (1996).

   i. Fraudulent Inducement. But judgment against insured on this theory will trigger "dishonesty" exclusion; settlement, however, could be covered.

B. Breach of Contract/Trademark Infringement

1. Scope of consent to trademark use, as set forth in licensing agreement, results in trademark infringement as to products under license.

2. Under CGL policy's "exception" to the "exclusion" barring coverage for trademark infringement, "advertising injury" coverage exists where the infringed mark is a "trademarked title," i.e., a registered trademark that identifies a product or line of products. *Houbigant, Inc. v. Federal Ins. Co*., 374 F.3d 192, 203 (3d Cir. 2004).

3. Exclusion's applicability? Proof of breach of contract not required, as tort liability exists whether or not the owner's scope-of-use "consent" is embodied in bilateral "contract" or some *non-contractual* statement of consent. *Houbigant, supra.*

4. Damages, such as diminution of brand equity, are available.

C. Breach of Contract/ "Securities Claim" (Repo Claim)

1. Mortgage lender contracts to sell loans to securitizing purchaser

2. Securitized or "to-be-securitized" lending agreements, under applicable state law, may be "securities." *Realtek Industries, Inc. v. Nomura Securities*, 939 F. Supp. 572, 579 (N.D. Ohio 1996)

3. Typical clause: Purchaser has right to demand that seller repurchase the loans if the market value of the loan was misstated in the sale contract.

4. Purchaser demands repurchase, claiming "misrepresentation" in connection with the sale of the loans – allegations which may state a claim under a state or federal securities statute (even without an allegation of scienter).

   • *E.g.,* under Cal. Corp. Code § 25401,"[i]t is unlawful for any person to offer or sell a security in [California] or buy or offer to buy a security in [California] by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

5. Under typical D&O policy, "Securities Claims" are covered both as to the corporate insured and the individual insured persons where securities "of" the insured company – i.e., securities *owned by* the insured company:

   • A claim, other than an administrative or regulatory proceeding against or investigation of a Company, made against any Insured:

      i. for a violation of any federal, state, local regulation, statute or rule regulating securities, including but not limited to the purchase or sale of, or offer to purchase or sell, securities which is:

      ii. brought by any person or entity based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving the purchase or sale of, or offer to purchase or sell, securities **of** the Company . . .

7. No reported judicial decision (yet).

II. Non-Recourse Settlements When Contra-Insurer Erroneously Denies Coverage

A. What is a Non-Recourse Settlement?

- An agreement by which the insured agrees with the claimant that the claimant will not enforce his/her claim against the personal assets of the insured, but only against the insured's insurance policy via an assignment to the claimant of the insured's chose in action against the insurer for denying coverage of the underlying claim. Otherwise known as a "*Miller-Shugart* settlement." *See Miller v. Shugart,* 316 N.W.2d 729 (Minn. 1982).

B. Partial or Full Risk

- Claimant may require some payment from insured in addition to "insurance rights." Or, claimant may take all the risk of establishing coverage, such as where insured is in bankruptcy and has no "personal assets" to commit.

C. Enforceability

1. In most states, claimant may recover the settlement from the policy proceeds to the extent that (1) the settlement is reasonable and was made in good faith, and (2) the claim was covered. *Miller v. Shugart, supra.*

2. The "settlement reasonableness" issue: whether the settlement is of an amount and of a nature that the settlement would have been made by a reasonably prudent person in the position of the insured.
   a. Courts divided on whether this is a question of fact for the jury or question of law for the courts.
      i. <u>Jury</u>: For example, *Atlantic Mut. Ins. Co. v. Truck Ins. Exch*., 797 F.2d 1288, 1296-97 (5th Cir. 1986).
      ii. <u>Court</u>: For example, *Alton M. Johnson Co. v. M.A.I. Co*., 463 N.W.2d 277, 279 (Minn. 1990).
   b. Courts divided on who has the burden of proving reasonableness (or lack of reasonableness).
      i. <u>Insurer (lack of reasonableness)</u>: For example, *Pepsico Inc. v. Continental Cas. Co.*, 640 F.Supp. 656, 666 (S.D.N.Y. 1986)
      iii. <u>Insured (reasonableness)</u>: For example, *United Servs. Auto Ass'n v. Morris,* 154 Ariz. 113, 120-21 (1987).
      iv. <u>Assignee/Claimant</u>: For example, *Miller v. Shugart, supra.*
   c. Courts divided on consequence of a finding that settlement was *not* reasonable:
      i. General rule: enforce settlement agreement up to, but not in excess of, reasonable amount.
      ii. However, where settlement amount is not just unreasonably high but also involves collusion/bad faith (e.g., where underlying claim is itself contrived or "kickbacks" are involved), courts will deem coverage forfeited. *E.g., Wolff v. Royal Ins. Co*., 472 N.W. 2d 233, 234-36 (S.D. 1991).

III. Maximizing Insurance Recovery, Net of Legal Fees

A. Mediate, and Mediate Early

1. Coverage disputes are often legal "winner-take-all" issues. Mediation offers way to eliminate "winner-take-all" risk via "reminder and reinforcement" from neutral party that "either party could lose it all."
2. Keeps legal fees to a minimum, maximizing net recovery to policyholder (and minimizing net loss to insurer).
3. Potentially salvages the insured-insurer business relationship.
4. Is it ever too early? No, unless the policyholder seeks control over forum selection, in which case suit should be filed first. However, mediation can occur after filing and prior to service of suit.

B. Recovering Litigation Costs in Coverage Actions

1. There is no "general rule" as to fee-shifting. States vary widely as to (a) whether policyholder litigation fees are recoverable at all, and (b) the "trigger" for recovery. (See attached spreadsheet for jurisdiction-by-jurisdiction breakdown.)
2. Is this a forum-selection issue? Maybe. Some courts deem the fee-shifting issue to be substantive issue that follows the choice-of-law determination under any borrowing statute. Other courts deem the issue procedural. Most often, the issue is not even raised and forum fee-shifting rules appear to apply "by default."

PART TWO:

MAXIMIZING THE INSURER-PROVIDED DEFENSE WHERE THE INSURER "RESERVES RIGHTS" BASED ON AN "UNDERLYING" GROUND

In litigations in which the Insurer is bound to furnish a defense, *some* sort of tripartite relationship exists among the Insurer, the Insured, and the Insured's counsel that defines *who* will defend the Insured and *what* that defense attorney must not to waive privileges in the course of attempting to "cooperate" with the Insurer relative to the underlying litigation.

I. Shifting the "Right to Select Defense Counsel" to the Insured

A. Duty-to-Defend clause: Insurer's right to select counsel and control defense

B. The Insured's right is to a "*conflict-free defense*" by competent counsel. *Villicana v. Evanston Ins. Co.*, 28 Cal. App. 4th 631, 648 (Cal. App. 2d Dist. 1994). Thus, where a cognizable conflict is present, the Insurer is legally *incapable* of meeting its "defense" obligation, and must provide some form of substituted performance.

1. The triggering "conflict": Coverage-position letter containing a "reservation-of-rights" which reserves, as a potential ground for non-coverage, an alternative ground for liability in the underlying action which, if established in the underlying action, would preclude coverage of the resulting judgment. For example, a claim for "negligent or fraudulent" misrepresentation.

2. The "substituted performance": who "chooses" counsel?

a. Majority View: The majority of states provide the Insured with an absolute right to choose counsel if a conflict exists. *E.g.*, *San Diego Navy Federal Union v. Cumis Ins. Society, Inc,* 162 Cal. App. 3d 358 (1984). *See also Northland Ins. Co. v. Heck's Service Co.*, 620 F. Supp. 107 (E.D. Ark. 1985); *American Family Life Assurance Co. v. United States Fire Co.*, 885 F.2d 826, 831 (11th Cir. 1989) (interpreting Georgia law); *Pepper Constr. Co. v. Casualty Ins. Co.*, 145 Ill. App. 3d 516, 519 (Ill. App. Ct. 1st Dist. 1986); *CHI of Alaska v. Employers Reinsurance Corp.*, 844 P.2d 1113, 1119 (Alaska 1993); *Previews, Inc. v. California Union Ins. Co.*, 640 F.2d 1026, 1028 (9th Cir. 1981); *Allstate Ins. Co. v. Noorhassan*, 551 N.Y.S.2d 942, 943 (2d Dep't 1990); *Golotrade Shipping & Chartering, Inc. v. Travelers Indem. Co.*, 706 F. Supp. 214, 218 (S.D.N.Y. 1989); *Union Ins. Co. v. Knife Co.*, 902 F. Supp. 877, 881 (W.D. Ark. 1995)("the law of various states, which appears to be the 'majority rule' also supports giving the choice of counsel to the Insured in a conflict situation"); c.f. *HK Systems, Inc. v. Admiral Insurance Co.*, 03cv0795, 2005 U.S. Dist. LEXIS 39939, * 48-49 (E.D. Wis. June 24, 2005)(insured obligated to pay the reasonable fees charged by counsel selected by insured where insurer indicated its agreement to that counsel).

b. Minority View: The Insurer has veto power over insured's selection of independent counsel. *See Finley v. Home Ins. Co.*, 975 P.2d 1145, 1151 (Haw. 1998)(holding insurer has veto power over insured's selection of independent counsel because "the best result is to refrain from interfering with the insurer's contractual right to select counsel and leave the resolution of the conflict to the integrity of retained defense counsel," contrary to the Hawaii Rules of Professional Conduct (which provide the insured with the right to refuse an insurer's tender of a defense under a reservation-of-rights at which point the insurer must either choose to defend unqualifiedly or allow the insured to conduct its own defense of the action wherein the insured would be responsible for all attorneys' fees related thereto)); *Federal Insurance Co., v. X-Rite, Inc., et al.,* 748 F. Supp. 1223, 1229 (W.D.Mich. 1990) (same).

II. Shifting the "Right to Control the Defense" to the Insured

A. In conflict/reserved-rights situation, Insurer may not intervene in or interfere with the Insured's relationship with its attorney or with the conduct of the defense. *HK Systems, Inc. v. Admiral Insurance Co.*, 03cv0795, 2005 U.S. Dist. LEXIS 39939 (E.D. Wis. June 24, 2005).

B. In re Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P. 3d 806 (Mont. 2000): "Substantial appearance of impropriety" created where defense counsel cedes to Insurer's intervention and/or interference, under color of Insurer-issued "billing guidelines," in the conduct of the defense. Ethical duty requires exercise of independent judgment and undivided loyalty to Insured, which was sole client under law of this jurisdiction, notwithstanding common interest with Insurer in defeating underlying claim. [Query: Would this result follow in "dual client" jurisdiction?]

III. Minimizing the Burden of the "Duty to Cooperate"

A. <u>Non-Privileged Documents and Information Relating to Underlying Action</u>: No difference in duty; reasonable cooperation required. However, proof of *injurious* breach is difficult because Insurer does not control defense. *See generally Clarke v. Allstate Ins. Co.*, 728 So.2d 135, 140-41 (Ala. 1998)(finding no obligation of insured to produce tax returns and other financial information as condition of payment of automobile property insurance claim); *State Farm Mutual Automobile Insurance Co. v. Holcomb*, 458 N.E.2d 441, 445 (Ohio Ct. App. 1983)(insurer's request for medical report not reasonable because report did not exist and the insurer had no right to order that a report be prepared "at least without offering to pay for it.")

B. <u>Non-Privileged Documents and Information Relating to Coverage Issues</u>: No difference in duty; reasonable cooperation required. *In re Envtl. Ins. Declaratory Judgment Actions*, 259 N.J. Super. 308, 317 (N.J. Super. Ct. App. Div. 1992)(holding that pursuant to insured's duty to cooperate, insured was required to disclosure "all material facts," which the court defined as "all of the facts within his knowledge and otherwise" that would aid the insurer in its determination of coverage under the policy)(citing *Waste Management v. International Surplus Lines Ins. Co*., 579 N.E.2d 322, 333 (Ill. 1991)) [*NB:* A minority of courts have taken the view that the cooperation clause does not extend to matters related solely to coverage. *Martin v. Travelers Indemn. Co*., 450 F.2d 542, 553 (5th Cir. 1971) (Mississippi law)].

C. <u>Privileged Communications Relating to Coverage Issues</u>: Duty does not exist as to issues with respect to which Insured and Insurer are putative adversaries. *San Diego Fed. Credit Union v. Cumis Ins. Soc'y*, 162 Cal. App. 3d 358 (Cal. 1984); *State of Wis. v. Hydrite Chemical Co.*, 582 N.W.2d 411, 421 (Wis. Ct. App. 1998)(a "broadly worded cooperation clause does not supersede the attorney-client privilege or work product doctrine"); *North River Ins. Co. v. Philadelphia Reinsurance Corp.*, 797 F. Supp. 363, 369 (D.N.J. 1992) (a cooperation clause does not require the insured to "give up wholesale its right to preserve the confidentiality of any consultation it may have with its attorney concerning the underlying claim and its coverage determination").

D. <u>Privileged Communications Relating to Underlying Action</u>: State-by-state analysis.

1. <u>"Sole Client" Jurisdictions</u>: Insured is the only client. (Majority rule and current trend).

a. <u>*No* Common Interest" Jurisdictions</u>: No duty to cooperate as to such information, and providing such cooperation could be unethical. (*See* Point II, 2nd bullet) Rationale against common interest: the doctrine only applies where defense counsel represents "two or more clients." *See State of Wis. v. Hydrite Chemical Co.*, 582 N.W.2d 411, 421 (Wis. Ct. App. 1998); Wis. Stat. Ann. § 905.03(4)(e); *Bituminous Casualty Corp. v. Tonka Corp.*, 140 F.R.D. 381, 386 (D. Minn. 1992) ("The rationale which supports the 'common interest' exception to the attorney-client privilege simply doesn't apply if the attorney never represented the party seeking the allegedly privileged materials"); *See e.g., North River Ins. Co. v. Philadelphia Reinsurance Corp.*, 797 F. Supp. 363, 367 (D.N.J. 1992)("the common interest doctrine is completely unleashed from its moorings in traditional privilege law when it is held broadly to apply in contexts other than when there is dual representation"); *Rockwell Internat. Corp. v. Superior Court*, 26 Cal. App. 4th 1255, 1267 (Cal. App. 2d Dist. 1994)(establishing that the common interest exception applies only where two or more clients have retained or consulted a lawyer upon a matter of common interest). However, pursuant to California Civil Code, independent counsel is never required to disclose to the Insurer any privileged materials relevant to coverage disputes. Cal Civ Code §2860(d)("independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action *except privileged materials relevant to coverage disputes*, and timely to inform and consult with the insurer on all matters relating to the action")(emphasis added)

b. <u>"Common Interest" Jurisdictions</u>: Because Insured and Insurer share a common interest in matters antagonistic to underlying claim, Insured has no expectation of confidentiality except as to parties outside that community of interests. Derives from the common law "exception" to general rule, codified by statute in some states, that the attorney-client privilege is *waived* when a protected communication is disclosed to a party other than a "client." *Waste Management v. International Surplus Lines Ins. Co.*, 579 N.E.2d 322 (Ill. 1991).

c. <u>"Implied Limited Waiver" Jurisdictions</u>: Agreement in policy to "cooperate" with Insurer as to matters of common interest effectively *waives* any privilege as to matter of common interest, as between Insured and Insurer, even if Insured is the sole client. *Waste Management v. International Surplus Lines Ins. Co.*, 579 N.E.2d 322 (Ill. 1991) [*NB*: Majority rule is (i) the attorney-client privilege is *not* waived simply by one party's undertaking of a duty to cooperate with a putative adversary (*Eastern Airlines Inc., v. United States Aviation Underwriters, Inc.*, 716 So.2d 340, 343 (Fla. Dist. Ct. App. 1998); *State of Wis. v. Hydrite Chemical Co.*, 582 N.W.2d 411, 421 (Wis. Ct. App. 1998), and (ii) an "at issue" waiver does not arise by the Insured suing the Insurer over coverage. *Rockwell Int'l Corp. v. Superior Court*, 26 Cal. App. 4th 1255, 1262 (1994)].

2. "Dual Client/Common Interest" Jurisdictions: Common interest as between Insured and Insurer on matters antagonistic to underlying claim permits *both* the Insured and the Insurer to be "clients" as to such matters. *See Pine Island Farmers Coop v. Erstad & Riemer, P.A.*, 649 N.W.2d 444, 450 (Minn. 2002)(dual representation is permissible if the insured has participated in a consultation with the attorney regarding the dual representation, and after being fully informed of the advantages and disadvantages, gives express consent); *Home Indem. Co. v. Lane Powell Moss & Miller*, 43 F.3d 1322, 1330 (9th Cir. 1995) (interpreting Alaskan law and holding that dual representation can exist if there is no conflict of interest between insured and insurer the insured expressly consented to the dual representation after consultation with counsel). Duty to provide materials relating to matters of common interest.

E. Risk of waiver in tripartite context

1. Plaintiff in underlying litigation may discover privileged material that Insured provided to Insurer where there does not exist any cognizable common interest, specific or statutory non-waiver rule, or joint client status. *In re Pfizer Inc. Sec. Lit.,* 1993 WL 561125 at *8 (S.D.N.Y. Dec. 23, 1993). Confidentiality or joint-defense agreement between Insured and Insurer may not preclude the waiver. *See Imperial Corp. v. Shields*, 167 F.R.D. 447, 451-57 (S.D. Cal. 1995)(waiver as to letter to insurer containing claim evaluation of counsel for insured).

2. Insurer may, in certain circumstances, use Insured-furnished privileged material in subsequent coverage litigation against the Insured. *Goldberg v. American Home Assur. Co*., 80 A.D.2d 409, 412 (1st Dep't 1981).

IV. Avoiding Liability for "Reimbursement" of Defense Costs

A. In some jurisdictions, the Insured is insulated from "reimbursement" liability as a matter of law where the policy does not require the Insured to reimburse defense costs if coverage is ultimately found lacking. *See General Star Indem. Co. v. V.I. Port Auth.*, No. 2001-188, 2008 U.S. Dist. LEXIS 43552 (D.V.I. May 29, 2008)(Insurer could not reserve any right to reimbursement for defense costs because no such right existed in the insurance policies); *General Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co*., 215 Ill. 2d 146, 164 (Ill. 2005)(holding that absent a provision in the insurance policy that would provide reimbursement to the insurer, the insurer cannot later attempt to amend the policy by including the right to reimbursement in its reservation-of -rights letter); *Shoshone First Bank v. Pacific Employers Insurance Co*., 2 P.3d 510, 514 (Wy. 2000)(holding that unless the insurance agreement states otherwise, the insurer is liable for all the costs of defending the action even if the insurer's reservation-of-rights letter specifically reserved the right to allocate the fees, expenses and indemnity payments when the case was resolved); *Liberty Mut. Ins. Co. v. Fag Bearings Corp.*, 153 F.3d 919, 924 (8th Cir. 1998)(applying Missouri law, the Eighth Circuit held that the insurer's duty to defend continued insurer remained as long as any question existed as to whether the underlying claims were covered by the insurance policy, therefore Insurer was not entitled to reimbursement of defense costs); *Emplrs Mut. Cas. Co. v. Indus. Rubber Prods.*, No. 04-3839, 2006 U.S. Dist. LEXIS 9242, *15 (D. Minn. Feb. 23, 2006) (holding that Minnesota law has interpreted the duty to defend consistent with Missouri's interpretation in *Liberty Mut. Ins. Co. v. Fag Bearings Corp.*, 153 F.3d 919, 924 (8th Cir. 1998); *Terra Nova Insurance Co. v. 900 Bar, Inc.*, 887 F.2d 1213 (3d Cir. 1989)(applying Pennsylvania law, the Third Circuit held that an insurer cannot recover defense costs even when it defends under a reservation-of-rights to recover defense costs if it is later determined there is no coverage).

B. In other jurisdictions, the Insurer may create a contingent liability for reimbursement of defense costs by unilateral declaration in the reservation-of-rights letter. *Resure, Inc. v. Chemical Distribs.*, 927 F. Supp. 190, 194 (M.D. La. 1996)(Applying New Mexico law, the court held that insurer was entitled to reimbursement after stating in its reservation-of-rights letter that there was a possibility it might seek reimbursement for any and all costs of defense).

C. In other jurisdictions, the manner by which the Insured responds to a demand is determinative. The Insured must explicitly agree to make reimbursement if coverage proves lacking. Thus, a unilateral declaration by the Insurer is insufficient to create that contingent obligation. *Tex. Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000)(a unilateral reservation-of-rights letter could not create a reimbursement obligation not contained in the insurance contract); *see also Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools*, Inc., 246 S.W.3d 42 (Tex. 2008)("an insurer that settles a claim against its insured when coverage is disputed may seek reimbursement from the insured should coverage later be determined not to exist if the insurer 'obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement'"); *United National Insurance Co. v. SST Fitness Corp.*, 309 F.3d 914 (6th Cir. 2002)(applying Ohio law, the Sixth Circuit held that insurer was entitled to reimbursement of defense costs where the insurer reserved the right to recover defense costs and the insured accepted payment of defense costs); *Colony Ins. Co. v. G & E Tires & Serv., Inc.*, 777 So. 2d 1034, 1038 (Fla. Dist. Ct. App. 2000)(a liability insurer's reservation-of-rights letter, coupled with the insured's acceptance of a defense, entitled the insurer to reimbursement for defense costs it had paid).

PART THREE:

AVOIDING THE D&O TRAPS OF UNTIMELY NOTICE AND UNDER-INSURANCE

I. **The "Untimely Notice" Trap**

A. **D&O policies are written on a claims-made basis.** This means the insured must give notice of a claim as soon as practicable. Failure to comply with this requirement may allow your insurer to deny coverage for what would otherwise be a paid claim. Failure to report a claim could result in a loss of coverage for that claim and for related claims as well. Late notice is one of the most common reasons insurers deny claims.

B. **Insureds who report claims late tend to do so for two reasons:**

1. They fail to recognize what constitutes a claim; or
2. They decide not to report a claim because they assume (incorrectly) that a claim can be resolved for less than the applicable retention.

C. **Recognizing claims:**

1. Claims are not limited to lawsuits!
2. A claim can be:
   a. written demand (such as an e-mail) for money;
   b. written demand (such as an e-mail) for services;
   c. correspondence (such as an e-mail) offering a tolling agreement;
   d. a civil, criminal or administrative proceeding;
   e. a subpoena;
   f. a proof of creditor's claim submitted in a bankruptcy case;
   g. a governmental investigation; and
   h. an angry e-mail or letter from a shareholder demanding governance changes.

D. **What "Claim-Catching" Systems are in Place?**

1. General counsel's office (legal correspondence)
2. Business correspondence files
3. Periodic coverage-counsel review of files

E. **Fallacious Reasoning for Not Reporting Claims**

1. Limited affect on self-insured retention.
2. Sooner or later a claim that everyone expected would "go away" blows up into a matter that exceeds your entire retention and pierces your insured layer.

F. **When Late Notice May Not be Late Notice**

1. Even where "too much" time has passed to give valid notice, there is nothing to lose to provide notice, anyway. In some jurisdictions, the Insured may be excused from giving timely notice and/or the Insured's response to the notice, if it fails to raise the timeliness issue, may be deemed a waiver of any "untimely notice" defense.

II. **The "Under-Insurance" Trap**

Buying directors' and officers' ("D&O") liability insurance requires navigating a maze of daunting complexity. Today, some 40 insurers offer a total of more than 80 different D&O policies. Even the simplest of these policies have an intimidating number of detailed definitions, exclusions and conditions, with nuances of wording that can have very costly consequences down the line. Narrow definitions and overly broad exclusions found in many standard policies can mean the difference between your policy covering a multimillion dollar loss or leaving you to pay the whole tab.

Fortunately, D&O policy forms are not cast in concrete. These policies are the most negotiable form of insurance coverage. Because the D&O market is soft, all insurance companies are willing to consider your suggestions and, in varying degrees, to tailor their policies to meet your needs by means of endorsements.

Too few insureds avail themselves fully of this opportunity, and, as a result, many discover devastating coverage shortfalls after a claim arises.

A. **Typical D&O Policy**

A traditional D&O policy will typically offer three main types of protection:

- Side A coverage which protects directors and officers against non-indemnifiable claims (i.e., claims for which the company either may not or cannot indemnify a director or officer due to legal or financial solvency reasons);
- Side B coverage which reimburses the company for amounts it pays to directors or officers as indemnification; and
- Side C coverage which pays losses arising out of certain securities claims against the company.

1. Only Side A coverage in the traditional D&O policy protects the individual directors and officers. Sides B and C protect the company's treasury.
2. D & O's are put at risk via a policy offering Side B and Side C coverage.
   a. covered company losses can erode or exhaust the limits of the policy, leaving the directors and officers underinsured or completely uninsured. This risk has become more severe as settlements and judgments against companies have increased in size.

b. Directors and officers also face increased competition for their traditional D&O insurance limits as partial settlements and opt out cases become more popular.

c. If corporation files for bankruptcy, bankruptcy court can freeze the policy limits during the bankruptcy proceeding, forcing the directors and officers to pay their own defense costs during what could be a multi-year litigation. Worse yet, the bankruptcy court could make the limits of a traditional D&O policy available to creditors. Either way, this could leave individual directors and officers without insurance protection when they need it most.

B. The New "Dedicated Limit" Policy Maximizes Coverage for the D & O's

1. Advantages generally. To help avoid the shortcomings of the traditional D&O policy, insurers developed the "dedicated limit" policy. These policies typically sit on top of a traditional D&O program and offer just Side A coverage. Thus, this policy maximizes D & O coverage. As explained above, Side A coverage only responds to losses of the directors and officers in those limited situations when the company may not or cannot indemnify those directors and officers, such as when the corporate insured is insolvent, in certain derivative actions, or where the company's certificate of incorporation or by-laws prohibit indemnification. Some examples of how the dedicated limit policy maximizes coverage:

a. Company losses cannot erode or exhaust the limit.

b. Cannot be treated as an asset of the bankruptcy estate. Thus, it will remain beyond the reach of the bankruptcy court and any creditors of the company.

c. Generally provides broader coverage than a traditional D&O policy. For example, a typical dedicated limit policy will be completely non-rescindable and non-cancelable once the premium has been paid.

d. Many of the exclusions generally found in a traditional D&O policy – such as the ERISA, failure to maintain insurance, pollution, libel/slander and defamation exclusions – are not included in a typical dedicated limit policy. A dedicated limit policy generally has several more insured friendly exclusions including the "insured vs. insured" and "employment practices" exclusions.

e. Can be structured to best meet the risk transfer needs of management.

2. Customized advantages. The dedicated limits policy can be structured in a manner tailored to the needs of the D & O's:

a. the policy can be structured as a straight Side A excess policy which will cover directors and officers on an excess basis above a company's traditional D&O program. This structure tends to be less expensive but offers less protection than other types of dedicated limit policies.

b. For broader coverage, a company can select a Side A difference-in-conditions ("DIC") policy which can serve as an excess policy or drop down to the primary position if the underlying traditional D&O program cannot or fails to respond (rightly or wrongly) due to: (1) rescission by the underlying insurers; (2) wrongful refusal and/or financial inability of the underlying insurers or the company to indemnify a loss; and/or (3) denial of coverage by the underlying insurers due to coverage exclusions that are not contained in the dedicated limit policy.

c. A company may also select an independent directors liability ("IDL") policy. This policy is similar to a Side A DIC policy except that an IDL policy only protects the independent or outside directors. The main advantage of an IDL policy (as opposed to a Side A or Side A DIC policy) from the perspective of the independent directors, is that the limits of an IDL policy cannot be eroded or exhausted by officers who typically face a greater risk of large defense costs, settlement amounts and judgments.

STATE	Refusal to Defend	Refusal to Indemnify	Any Contract Case	SOURCE/AUTHORITY	NOTES
Alabama	Y*	N	N	*Jackson v. Nat'l Sec. Fire and Cas. Co.*, 962 So.2d 855, 863 (Ala. 2006); §§ 12-19-272 - 73, Ala.Code 1975	Alabama follows the American Rule, with no exception for insurance coverage cases (whether or not dec. jdgmt. cases, and regardless of size). However frivolous or unjustified denials of coverage may subject the insurer to an attorney fee award under Alabama's Litigation Accountability Act. Although authority for the proposition that it is available is sparse, Alabama courts have occasionally awarded attorney fees in duty to defend cases. *See, e.g., Alabama Farm Mut. Cas. Ins. Co. v. Harris*, 184 So.2d 837 (Ala. 1966). This appears to be based on an equitable theory, in which case it may only be available in dec. jdgmt. actions.
Alaska	Y	Y	Y	Alaska R. Civ. P. 82	Alaska follows a modified English Rule in all civil matters. In bad faith and refusal to defend cases, enhanced fees and damages may be available.
Arizona	Y	Y	Y	Ariz. Rev. Stat. §12-341.01	By statute, Arizona permits fee shifting in any breach of contract case.
Arkansas	Y	Y	Y	Ark. Code Ann. § 16-22-308 (Reply. 1999); Ark. Code Ann. § 16-22-308; *See also Med. Liability Mutual Ins. Co. v. Alan Curtis Enter.*, 2008-AR-0601.010 (May 29, 2008) *rehearing denied* 2008-AR-0627.004 (June 26, 2008)	The insured may recover fees against the insurance company in a declaratory judgment action for coverage under the policy.
California	Y	Y	N	Cal. Code Civ. P. § 1021; *Brandt v. Superior Court*, 693 P.2d 796, 799 - 801 (1985).	In general, California follows the American rule except in common fund, substantial benefit, and private AG cases. *See Gray v. Don Miller & Associates, Inc.*, 35 Cal.3d 498, 504 (1984); Cal. Code Civ. P. § 1021. An insurance contract can specify that attorney fees will be paid, however. Moreover, when an insured must obtain the assistance of counsel in order to obtain the benefit of the insurance contract, the attorney fees are assessed as a measure of *damages*, not as a separate cost item, and are fully recoverable.
Colorado	N	N	N	§ 13-17-101 *et seq*, C.R.S.2002; *Continental Western Ins. Co. v. Heritage Estates Mutual Housing Ass., Inc.*, 77 P.3d 911, 913, 915 - 16 (2003).	Colorado's statutes are clear that attorney fee awards are not available. The Colorado Court of Appeals has interpreted this to mean that attorney fees are generally unavailable unless a contract otherwise provides, the claim or defense is frivolous, or the insurer acts in bad faith (triggering another statutory regime).
Connecticut	N	N	N	[illegible] *York Mut. Ins. Co.*, 282 Conn. 576 (Conn.2007) (p. 708, "Even without an authorizing contractual or statutory provision, a trial court may award attorney's fees to a policyholder that has prevailed in a declaratory judgment action against its insurance company only if the policyholder can prove that the insurer has engaged in bad faith conduct prior to or in the	Connecticut permits an attorney fee award "only if the policyholder can prove that the insurer has engaged in bad faith conduct prior to or in the course of the litigation."
Delaware	N*	N*	N	*EI Du Pont DeNemours and Co. v. Admiral Ins. Co.*, 1994 wl 465547 (Del. Super 1994).	Attorney fees are not generally allowed, and are not allowed in casualty cases. A special rule prevails in property cases, however, permitting recovery. 18 Del. C. 4102.
Florida	Y	Y	N	F.S.A. 627.428.	Attorney fees allowed when insured is successful in coverage action.
Georgia	N	N	N	Ga. Code Ann. 33-4-6; OCGA 33-7-15(b.1).	Attorney fees allowed when insurer acts in bad faith. Also, under Georgia's no fault rules, attorney fees are allowed in automobile insurance coverage cases. *Stedman v. Cotton States Ins. Co.*, 562 S.E.2d 256 (Ga. App. 2002).
Hawaii	Y	Y	N	HRS § 431:10-242 (2005); *Commerce & Industry Insurance Co. v. Bank of Hawaii*, 832 P.2d 733, 737 (1992).	HRS § 607-14 permits recovery of attorney fees up to 25% of a money judgment if a contract so provides. Other sections of HRS § 607-14 also permit attorney fee awards - for instance, against frivolous claims or defenses.
Idaho	Y*	Y*	N	I.R.C.P. 54(e)(1); *but see* § 12-120, Idaho Code (permitting discretionary fee awards in cases worth less than $25,000); 12-121 (permitting discretionary fee awards generally).	Provided a demand for benefits or defense is made at an appropriate time prior to filing suit, attorney fees may be awarded at the discretion of the court.
Illinois	N	N	N	*Taco Bell Corp. v. Continental Cas. Co.*, 388 F.3d 1069, 1077 (7th Cir. 2004); as to bad faith 215 ILL. Comp. Stat 5/155	The rules differ for bad faith claims, where attorney fees may be available.
Indiana	N	N	N	*Liberty Mutual Insurance Company v. OSI Industries, Inc.*, 831 N.E.2d 192, 205 (Ind. App. 2005); *Masonic Temple Ass'n of Crawfordsville v. Indiana Farmers Mutual Ins. Co.*, 837 N.E.2d 1032, 1039 (Ind. App. 2005).	Attorneys fees are not allowed in the absence of a statute or some agreement or stipulation authorizing such an award. Thus, first-party attorney fee awards are not generally available. However, "when defendant's breach of contract caused the plaintiff to engage in litigation with a third party to protect its interests and such action would not have been necessary but for the defendant's breach, attorneys fees and litigation expenses incurred in litigation with a third party may be recovered as an element of plaintiff's damages from defendant's breach of contract." *Masonic Temple Ass'n of Crawfordsville v. Indiana Farmers Mutual Ins. Co.*, 837 N.E.2d 1032, 1039 (Ind. App. 2005).
Iowa	N	N	N	*Brown TP. Mut. Ins. Ass'n. v. Kress*, 330 N.W.2d 291, 300 (Iowa 1983) (quoting *Deaton v. Allstate Ins. Co.*, 548 S.W.2d 162, 164 (Ky.App. 1977)).	Iowa, like Kentucky, treats attorney fees as consequential damages. In a breach of contract case, consequential damages are not appropriately awarded - the appropriate measure is expectation damages. Therefore attorney fees are generally unavailable. Additionally, Iowa does not recognize a tort in first-party insureds for bad faith.
Kansas	Y			*Guaranty Nat'l Ins. Co. v. McGuire*, 192 F. Supp. 2d 1204, 1206-07 (D. Kan. 2002)	
Kentucky	N	N	N	*Nucor Corp. v. General Electric Co.*, 812 S.W.2d 136 (Ky. 1991).	The general rule is, "with the exception of a specific contractual provision allowing for recovery of attorneys' fees or a fee-shifting statute, ...each party assumes responsibility for his or her own attorneys' fees." *See also Deaton v. Allstate Ins. Co.*, 548 S.W.2d 162, 164 (Ky.App. 1977) and discussion of same in Iowa, *supra*.
Louisiana	Y	Y	Y	*Steptore v. Masco Const. Co., Inc.*, 643 So.2d 1213 (1994). Counsel fees in coverage action may be allowed. *Little v. Kalo Laboratories, Inc.*, 424 So.2d 1065, 1069 (La.App. 2 Cir., 1982) ("stating that an insurer had made the "conscious and arbitrary decision not to honor its policy obligation."	Attorney fees may be awarded when authorized by contract or statute.
Maine	Y	N	N	[illegible] an action…to determine an insurer's contractual duty to defend an insured under an insurance policy, if the insured prevails in such action, the insurer shall pay court costs and reasonable attorneys fees."; *Foremost Insurance Company v. Levesque*, 926 A.2d 1185, 1187-88 (2007); *Maine Mut. Fire Ins. Co. v. Gervais*, 745 A.2d 360, 362 (Me. 1999).	
Maryland	Y	Y	N	*Bausch & Lomb, Inc. v. Utica Mutual Ins. Co.*, 355 Md. 566, 591 (Md. 1999).	Attorney fees are recoverable in duty to defend and denial of coverage instances, but this rule is limited to third party liability coverage and does not apply to actions against insurer to enforce 1st party coverage.

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Massachusetts	Y	N	N	G.L.c. 151B, s9*;* City of Lowell v. Massachusetts Com'n Against Discrimination, 840 N.E.2d 553, 554 (Mass. App. Ct. 2006) *Rubenstein v. Royal, Ins. Co. of America*, 429 Mass. 355 (Mass. 1999)	
Michigan	N	N	N	MCL 500.3148	Under the statute, an insurer's *reasonable* withholding of coverage does not entitle the insured to attorney fees. An unreasonable withholding, however, exposes the insurer to a *mandatory* (non-discretionary) award of full reasonable fees. A decision is not unreasonable if "based on a legitimate question of statutory construction, constitutional law, or factual uncertainty." *Attard v. Citizens Ins. Co. of America*, 602 N.W.2d 633, 638 (1999).
Minnesota	Y	N	N	*In re: Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405, 422-23 (Minn. 2003); *Morrison v. Swenson*, 274 Minn. 127, 142 N.W.2d 640 (1966).	For over 100 years it has been the law in Minnesota that attorney fees are only recoverable by a prevailing party when there is statutory authorization or a contractual agreement allowing those fees. However, a narrow exception to the general rule permits recovery when an insurer breaches its duty to defend.
Mississippi	N*	N*	N	See Notes.	permissible in a general contract action unless statute or contract so authorize, *or unless punitive damages are also available. Stokes v. Bd. of Directors of La Cav Imp. Co.*, 654 So.2d 524, 529 (Miss. 1995). Nonetheless, Mississippi has permitted attorney fee awards in insurance failure-to-pay cases when the failure was unreasonable, using a sort of tort theory. *See Willard v. Paracelsus Health Care Corp.*, 681 So.2d 539, 544-45 (Miss. 1996); *Univ. Life Ins. Co. v. Veasley*, 610 So.2d 290 (Miss. 1992). This area of law is not yet well-developed, and while it is unclear whether Mississippi will allow attorney fees in unreasonable failure to pay cases, it likely will not extend such awards to general failure to pay. *See Willard*, 681 So.2d at 545 (limiting *Veasley* to its facts).
Missouri	Y	N	N	*Travelers Indem. Co. v. Bruns*, 701 S.W.2d 195 (Mo.App.E.D. 1995); *American Economy Ins. Co. v. Ledbetter*, 903 S.W.2d 272 (Mo.App. S.D. 1995) (citations omitted).	Attorney fees not typically recoverable in insurance coverage litigation unless contract or statute states otherwise. However, attorney fees may be awarded in "unusual circumstances." While the absence of "bad faith" in filing suit is a factor in arriving at equity and justice in assessing costs, such absence does not compel denial of attorney fees.
Montana	Y	Y	N	Mountain West Farm Bureau Mut. Ins. Co. v. Brewer, 69 P.3d 652 (Mont. 2003)	
Nebraska	Y	Y	N	Neb. Rev. Stat. §44-359	Note that an attorney fee award is *mandatory* under Nebraska law. *Rieschick Drilling Co. v. American Cas. Co.*, 303 N.W.2d 264 (Neb. 1981).
Nevada	Y*	Y*	Y*	NRS 18.010	Attorney fees are available by statute only in low-value cases in which there is a money recovery. Note that the rules are different in declaratory judgment actions, where Nevada's rules do not generally permit any attorney fee recovery. *See Smith v. Crown Financial Svcs.*, 890 P.2d 769, 774-75 (Nev. 1995); *City of Las Vegas v. Cragin Indus.*, 478 P.2d 585, 590 (Nev. 1970). Fee recovery under Nevada's hybrid American/English rule is only permitted for low-value (less than $20,000) cases.
New Hampshire	Y	Y	N	N.H. Rev. Stat. Ann. §461:22-b	
New Jersey	Y	Y		N.J.Ct.R. 4:42-9 (a)(6)	
New Mexico	N	N	N	NMSA 1978, § 59A-16-30(B) (1990)	Attorney fees are not recoverable as damages in New Mexico. *State ex rel. Roberson v. Bd. of Educ.*, 372 P.2d 832, 836-37 (N.M. 1962). Thus, they are only recoverable if a statute or contract so authorizes. New Mexico's Insurance Code generally permits recovery of fees for a "willful" refusal to provide coverage. NMSA 1978, § 59A-16-30(B) (1990). As this is within New Mexico's Unfair Trade Practices section of the Insurance Code, "willful" likely equates to "bad faith".
New York	Y	N	N	*Employer's Mut. Cas. Co. v. Key Pharms.,* 75 F.3d 815, 824 (2d Cir. 1996); as to bad faith, *Sukup v. State*, 227 N.E.2d 842 , 844 (N.Y. 1967).	only to cases where the insured is defending (not where the insured is the plaintiff), and only in duty to defend cases. This is because of its curious derivation - the Court finds the duty to pay attorney fees in the insurance contract itself, specifically in the duty to defend. Because the insurer has a duty to defend the insured against claims arising out of covered injuries, and because the coverage dispute itself arises out of the covered injury, the insurer must pay the insured's costs of defense. Presumably it does not apply when the insured brings the suit, because the insured then causes the injury and insured-caused injuries are not covered. This being the logic, one wonders if the insurer could, for instance, assert its right to control the defense of the "covered claim,"
North Carolina	Y	Y	Y	*Contractors, Inc. v. Michigan Mut. Ins. Co.*, 157 N.C.App.572 (2003); NC St. 6-21.1 Allowance of Counsel Fees as Part of Costs in Certain Cases, "In any personal injury or property damage suit, or suit against an insurance company under a policy issued by the defendant insurance company and in which the insured or beneficiary is thep laitniff,	Attorney fees recoverable when insurer acts in bad faith, is authorized by statute or contained in contract.
North Dakota	Y	Y	N	*State Farm Fire and Cas. Co. v. Sigman*, 508 N.W.2d 323, 325-27 (N.D. 1993).	The North Dakota court has found, in the duty of defense language in an insurance policy, a correlative duty to bear the attorney fees of its insured in a declaratory judgment action to determine coverage, provided the insured is the prevailing party. *See generally Western Nat'l Mut. Ins. Co. v. Univ. of North Dakota*, 643 N.W.2d 4 (N.D. 2002). *See also* N.D.C.C. § 32-23-08.
Ohio	Y			*Westfield Cos. V. OKL Can Line*, 155 Ohio App.3d 747 (Ohio App. 1 Dist. 2003).	In a general duty to defend case, attorney fees are available. Moreover, in a declaratory judgment action attorney fees may be available *even to a non-prevailing party.* R.C. 2721.09; *United States Fid. And Guar. Co. V. St. Elizabeth Med. Center*, 129 Ohio App3d 45 (1998).
Oklahoma	Y			Okla. Stat. Ann. §3629	Prevailing party in a declaratory action may be awarded costs and fees.
Pennsylvania	N	N	N	2503 (Purdon); *Montgomery Ward & Co. v. Pacific Indemnity Co.*, 557 F.2d 51, 57-59 (3d Cir.1977). As to bad faith cases, see *TIG Ins. Co. v. Nobel Learning Comm., Inc.*, No. 01-4708, 2002 U.S. Dist., 2002 WL 1340332 at *18 (E.D. Pa. June 18, 2002); *Kelmo Enterprises Inc. v. Commercial Union Insurance Company,* 426 A.2d 680, 685 (Pa. Super 1981).	Attorney fees can be assessed against the losing party only if it is found to have acted in bad faith.

STATE	Refusal to Defend	Refusal to Indemnify	Any Contract Case	SOURCE/AUTHORITY	NOTES
Rhode Island	Y	N	N	*Ins Co. of North America v. Kayser-Roth Corp.*, 770 A.2d 403 (R.I. 2001); *United States v. Kayser-Roth Corp.*, 724 F.Supp. 15 (D.R.I. 1989).	Rhode Island permits attorney fee awards in bad faith cases and refusal to defend cases, but does not generally permit them in refusal to indemnify cases. *But see Insurance Co. of North America v. Kayser Roth Corp.* 1999 WL 813661, *48 (R.I. 1999) ("the law is well settled that '[a]n insurer who denies coverage does so at its own risk, and, although its position may not have been entirely groundless, if the denial is found to be wrongful it is liable for the full amount which will compensate the insured for all the detriment caused by the insurer's breach of the express and implied obligations of the contract," and "[w]hen an insurer brings a declaratory judgment action to determine its duty to defend and indemnify which is unsuccessful, it must pay the insured for the defense of both the underlying action and the declaratory judgment
South Carolina	N	N	N	Code 1976 38-59-40; 274 S.C. 468 (1980)	Attorney fees recoverable when insurer unreasonably refuses to defend, but not when the refusal is reasonable.
South Dakota	N	N	N	SDCL 58-12-3.	South Dakota's dec. judgmt. act does not permit attorney fee shifting, *Public Entity Pool for Liability v. Score*, 658 N.W.2d 64, 68 (S.D. 2003), and its insurance code generally provides for fees only when the insurers conduct in refusing coverage was vexatious or without reasonable cause. SDCL 58-12-3. Note that attorney fees are available in bad faith cases even if it is the insurer who initiates a dec. judgmt. action. *All Nation Ins. Co. v. Jeffrey W.*, 344 N.W.2d 493 (S.D. 1984).
Tennessee	N	N	N	*State ex rel. Orr v. Thomas*, 585 S.W.2d 606 (Tenn. 1979).	In the absence of a contract, statute or recognized ground of equity so providing, there is no right to have attorney's fees paid by an opposing party in civil litigation. The result is different in bad faith cases. Tenn. Code Ann. 56-7-105.
Texas	Y	Y	Y	Tx. Civ. Prac. & Rem. §§ 37.009 & 38.001.	Texas permits discretionary fee shifting (attorney fees are taxed as costs) in declaratory judgment actions. Tx Civ. Prac. & Rem. § 37.009. Fee shifting is also permissible in contract cases generally. Tx. Civ. Prac. & Rem. § 38.001(8). The procedure is truly odd for non-Texas practitioners - the reasonableness of the attorney fee award is a jury question, and testimony is taken from attorneys as expert witnesses. *See Thomas v. Bobby D. Associates*, 2008-TX-0808.258 (August 6, 2008). In bad faith cases, Texas law provides for fee shifting and treble damages. Tx. Ins. Code § 541.152.
Utah	N	N	N	*Farmers Ins. Exch. v. Call*, 712 P.2d 231, 237 (Utah 1985)	Fee shifting is only available in bad faith claims.
Vermont	N	N	N	*Concord Gen. Mut. Ins. Co. v. Woods*, 824 A.2d 572, 579 (Vt. 2003).	The Court will not award attorney fees, which are discretionary, "[i]n the absence of a finding of bad faith on the part of the insurance company, or outrageous conduct creating the dominating reasons of justice [it has] held to be necessary to justify a departure from the American Rule". *Concord Gen. Mut. Ins. Co. v. Woods*, 824 A.2d 572, 579 (Vt. 2003).
Virginia	Y	Y	N	*Scottsdale Ins. Co. v. Glick*, 240 Va. 283 (1990).	Attorney fees recoverable when insurer acts in bad faith.
Washington	Y	Y	N	*Olympic S.S. Co., Inc. v. Centennial Ins. Co.*, 811 P.2d 673, 681 (Wash. 1991).	*Olympic S.S. fees are available whenever an insured must litigate to cause the insurer to pay appropriate coverage, regardless of whether such litigation is instituted by insured or insurer and regardless of whether it is a dec. jdgmt. action or a damages action. The theory of the Court appears to be that attorney fees are a component of the damages sustained by the insured by the insurer's failure to defend or indemnify, and the insurance contract requires the insurer to pay for all of the damages sustained. As with New York's Mighty Midget rule, one wonders what happens when the attorney fees are greater than the policy limits, so the contract rationale no longer holds up.*
West Virginia	Y	Y	N	*Aetna Cas. & Sur. Co. v. Pitrolo*, 176 W.Va. 190 (W.Va. 1986).	The prevailing party in a property damage insurance case gets counsel fees. *Hayseed's Inc. v. State Farm Fire & Cas.*, 177 W.Va. 323 (1996). Moreover, the successful insured in a dec. jdgmt. action to establish or deny the existence of coverage can recover attorney fees (whether such action was brought by insured or insurer).
Wisconsin	Y*	N	N*	Wis. Stat. §806.04	Wisconsin's Uniform Dec. Judgmt. Act. provides for awards of "costs." Wis. Stat. § 806.04(10). Moreover, "costs" are generally subject to a discretionary award by the court in most cases. Wis. Stat. § 814.01 - 03. Costs include a *very* small attorney fee award (around $300). Wis. Stat. § 814.04(1). However, when the insurer fails to defend, Wisconsin courts have invoked equitable powers under the Dec. Jdgmt. Act, *see* Wis. Stat. § 806.04(8), to permit full recovery of fees. *Elliott v. Donahue*, 169 Wis.2d 310, 324-25 (1992). Note that the Plaintiff's *attorney* is generally liable for costs taxed for the benefit of defendant until the plaintiff posts a security for such costs. Wis. Stat. § 814.34. Attorney fees are broadly available in bad faith cases. *DeChant v. Monarch Life Ins. Co.*, 547 N.W.2d 592, 571-77 (Wis. 1996).
Wyoming	N	N	N	See Notes.	Wyoming glosses the American Rule in the same manner as Mississippi - fees are not shifted unless statute or contract so permit, or unless punitive damages are awarded. *Campbell County School Dist. v. State*, 181 P.3d 43, 70 (Wyo. 2008). This may make fees available in bad faith actions. As in most other states, unfair claims settlement practices are prohibited in Wyoming. Unlike most other states, Wyoming's statute does not expressly state that this is not intended to confer a private right of action separate from a tort of bad faith. Thus, systematic but not bad-faith failures to settle may provide another ground for litigation about attorney fee awards. When available, attorney fees are left to the discretion of the court, with no jury requirement. Wyo. Stat. 1-14-126.

PART THREE:

AVOIDING THE D&O TRAPS OF UNTIMELY NOTICE AND UNDER-INSURANCE

I. The "Untimely Notice" Trap

A. D&O policies are written on a claims-made basis. This means the insured must give notice of a claim as soon as practicable. Failure to comply with this requirement may allow your insurer to deny coverage for what would otherwise be a paid claim. Failure to report a claim could result in a loss of coverage for that claim and for related claims as well. Late notice is one of the most common reasons insurers deny claims.

B. Insureds who report claims late tend to do so for two reasons:

1. They fail to recognize what constitutes a claim; or

2. They decide not to report a claim because they assume (incorrectly) that a claim can be resolved for less than the applicable retention.

C. Recognizing claims:

1. Claims are not limited to lawsuits!

2. A claim can be:

(a) a written demand (such as an e-mail) for money;

(b) a written demand (such as an e-mail) for services;

(c) correspondence (such as an e-mail) offering a tolling agreement;

(d) a civil, criminal or administrative proceeding;

(e) a subpoena;

(f) a proof of creditor's claim submitted in a bankruptcy case;

(g) a governmental investigation; and

(h) an angry e-mail or letter from a shareholder demanding governance changes.

D. What "Claim-Catching" Systems are in Place?

1. General counsel's office (legal correspondence)
2. Business correspondence files

3, Periodic coverage-counsel review of files

E. Fallacious Reasoning for Not Reporting Claims
.
1. Limited affect on self-insured retention.

2. Sooner or later a claim that everyone expected would "go away" blows up into a matter that exceeds your entire retention and pierces your insured layer.

F. When Late Notice May Not be Late Notice

1. Even where "too much" time has passed to give valid notice, there is nothing to lose to provide notice, anyway. In some jurisdictions, the Insured may be excused from giving timely notice and/or the Insured's response to the notice, if it fails to raise the timeliness issue, may be deemed a waiver of any "untimely notice" defense.

II. The "Under-Insurance" Trap

Buying directors' and officers' ("D&O") liability insurance requires navigating a maze of daunting complexity. Today, some 40 insurers offer a total of more than 80 different D&O policies. Even the simplest of these policies have an intimidating number of detailed definitions, exclusions and conditions, with nuances of wording that can have very costly consequences down the line. Narrow definitions and overly broad exclusions found in many standard policies can mean the difference between your policy covering a multimillion dollar loss or leaving you to pay the whole tab.

Fortunately, D&O policy forms are not cast in concrete. These policies are the most negotiable form of insurance coverage. Because the D&O market is soft, all insurance companies are willing to consider your suggestions and, in varying degrees, to tailor their policies to meet your needs by means of endorsements.

Too few insureds avail themselves fully of this opportunity, and, as a result, many discover devastating coverage shortfalls after a claim arises.

A. Typical D&O Policy

A traditional D&O policy will typically offer three main types of protection:

- Side A coverage which protects directors and officers against non-indemnifiable claims (i.e., claims for which the company either may not or cannot indemnify a director or officer due to legal or financial solvency reasons);

- Side B coverage which reimburses the company for amounts it pays to directors or officers as indemnification; and

- Side C coverage which pays losses arising out of certain securities claims against the company.

1. Only Side A coverage in the traditional D&O policy protects the individual directors and officers. Sides B and C protect the company's treasury.

2. D & O's are put at risk via a policy offering Side B and Side C coverage.

   (a) covered company losses can erode or exhaust the limits of the policy, leaving the directors and officers underinsured or completely uninsured. This risk has become more severe as settlements and judgments against companies have increased in size.

   (b) Directors and officers also face increased competition for their traditional D&O insurance limits as partial settlements and opt out cases become more popular.

   (c) If corporation files for bankruptcy, bankruptcy court can freeze the policy limits during the bankruptcy proceeding, forcing the directors and officers to pay their own defense costs during what could be a multi-year litigation. Worse yet, the bankruptcy court could make the limits of a traditional D&O policy available to creditors. Either way, this could leave individual directors and officers without insurance protection when they need it most.

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1. Advantages generally. To help avoid the shortcomings of the traditional D&O policy, insurers developed the "dedicated limit" policy. These policies typically sit on top of a traditional D&O program and offer just Side A coverage. Thus, this policy maximizes D & O coverage. As explained above, Side A coverage only responds to losses of the directors and officers in those limited situations when the company may not or cannot indemnify those directors and officers, such as when the corporate insured is insolvent, in certain derivative actions, or where the company's certificate of incorporation or by-laws prohibit indemnification. Some examples of how the dedicated limit policy maximizes coverage:

   (a) Company losses cannot erode or exhaust the limit.

   (b) Cannot be treated as an asset of the bankruptcy estate. Thus, it will remain beyond the reach of the bankruptcy court and any creditors of the company.

   (c) Generally provides broader coverage than a traditional D&O policy. For example, a typical dedicated limit policy will be completely non-rescindable and non-cancelable once the premium has been paid.

   (d) Many of the exclusions generally found in a traditional D&O policy – such as the ERISA, failure to maintain insurance, pollution, libel/slander and defamation exclusions – are not included in a typical dedicated limit policy. A dedicated limit policy generally has several more insured friendly exclusions including the "insured vs. insured" and "employment practices" exclusions.

   (e) Can be structured to best meet the risk transfer needs of management.

2. Customized advantages. The dedicated limits policy can be structured in a manner tailored to the needs of the D & O's:

   (a) the policy can be structured as a straight Side A excess policy which will cover directors and officers on an excess basis above a company's traditional D&O program. This structure tends to be less expensive but offers less protection than other types of dedicated limit policies.

   (b) For broader coverage, a company can select a Side A difference-in-conditions ("DIC") policy which can serve as an excess policy or drop down to the primary position if the underlying traditional D&O program cannot or fails to respond (rightly or wrongly) due to: (1) rescission by the underlying insurers; (2) wrongful refusal and/or financial inability of the underlying insurers or the company to indemnify a loss; and/or (3) denial of coverage by the underlying insurers due to coverage exclusions that are not contained in the dedicated limit policy.

   (c) A company may also select an independent directors liability ("IDL") policy. This policy is similar to a Side A DIC policy except that an IDL policy only protects the independent or outside directors. The main advantage of an IDL policy (as opposed to a Side A or Side A DIC policy) from the perspective of the independent directors, is that the limits of an IDL policy cannot be eroded or exhausted by officers who typically face a greater risk of large defense costs, settlement amounts and judgments.

Current Business and Legal Trends Affecting Directors & Officers Liability:

Securities Claims

As the single largest source of liability against directors and officers (D&Os), securities claims remain a key area of concern. Over the past 12 months, we have seen a number of significant trends in this arena:

- For the first time in history, all of the top ten shareholder class action settlements exceeded $1 billion. We are continuing to see enormous settlements. Nine of the ten largest settlements of all time have occurred in the past three years.
- Average investor losses have grown dramatically over the last decade, from $134 million in the average suit settling in 1996 to approximately $2 billion in 2006. Because investor losses are the most significant driver in determining settlement values, the higher investor losses for more recently resolved cases may explain the rise in settlement values.
- While average and median settlement values are rising, the majority of securities class action cases still settle for less than $10 million. In fact, from 2005-2007, 37 percent of cases have been resolved for less than $5 million and 57 percent for less than $10 million.
- The existence of allegations concerning accounting improprieties in a complaint leads to an increase in the value of the expected settlement by approximately 20 percent. In cases where there are admitted irregularities, the settlement value increases by nearly 50 percent.
- The pace of federal securities class action filings remains below historic norms. From 1998 to 2005 more than 200 cases were filed per year. 2006 saw a dip in the number of class actions with only 136 cases filed during that year. Through the end of November 2007, 157 cases have been filed, 28 of which are related to the fallout in the mortgage industry.
- The securities class action numbers do not include many of the stock option cases, most of which were filed as derivative cases. There have been nearly 30 class action suits and 160 stock derivative suits related to stock options filed to date.
- Settlements have been shown to increase by an average of approximately one-third if an IPO is involved.
- Recent turmoil in the subprime lending market has led to 28 securities class action lawsuits claims through November, and may be a source of significant filings over the near term.

The Tellabs *Case*

The U.S. Supreme Court's decision in *Tellabs v. Makor,* which was decided on June 21, 2007, clarified the pleading standard required in a securities case filed pursuant to section 10b-5 of the Securities Exchange Act of 1934. The court adopted a pleading standard saying that the plaintiffs' pleading of scienter must be more than merely plausible or reasonable—it must be cogent and at least as plausible as any opposing inference of nonfraudulent intent. The overall impact on the filing of securities class actions is expected to be minimal other than perhaps to reallocate the filings in the various appeals courts by arguably making it easier for plaintiffs to file cases in the 9th and 11th Circuit Courts, which had a more stringent pleading standard than the 2nd and 3rd Circuit Courts.

The Credit Suisse Case

The U.S. Supreme Court's decision in *Credit Suisse v. Billing*, which was decided on June 18, 2007, held that conduct is impliedly immune from suit under the antitrust laws if that conduct falls within the scope of the securities laws. The case arose in the context of an antitrust case brought against underwriters arising out of the IPO "laddering" claims. The case is regarded as a win for the business community and establishes clear guidelines for the application of the implied antitrust immunity doctrine in securities cases and should remove the potential for treble damages associated with antitrust suits in what otherwise are securities-related cases.

The Stoneridge Case

Oral arguments were presented in *Stoneridge Investment Partners v. Scientific-Atlanta* on October 9, 2007. Stoneridge, a shareholder of Charter Communications, alleges that Scientific-Atlanta and Motorola were part of a scheme to defraud Charter's shareholders and as a result are liable to Charter's shareholders for their participation in the fraud. The district court and the 8th Circuit both dismissed the claims against Scientific-Atlanta and Motorola, and the plaintiffs appealed to the Supreme Court.

If the court rules in favor of Stoneridge, the case could have significant implications for any parties that do business with a public issuer—in particular, banks, accounting firms, lawyers or any other "deep pocket" entities—all of whom would be very attractive targets for the plaintiffs' bar. A ruling in the case may come as early as the end of the year.

Derivative Claims

It has become increasingly common for the plaintiffs' bar to file "tagalong" state derivative cases in connection with federal class action securities cases. Recently, it has also been common to file derivative actions associated with stock option backdating issues as well as merger and acquisition issues. Derivative claims have traditionally settled for corporate therapeutics, enhanced disclosure, or other non-monetary relief, disgorgement of ill-gotten gains (if they were so alleged) and often plaintiffs' fees, which can range from a small sum to more than $20 million. In addition, derivative claims are usually brought under state law. As a result, defendants in such actions typically will not be afforded the same protections available under the Private Securities Litigation Reform Act (PSLRA) in connection with federal securities claims. Finally, state law derivative actions present a real risk of multiple actions and potentially inconsistent adjudications.

Backdating of Stock Options

Over the past 18 months, we have witnessed an explosion of regulatory inquiries, investigations, derivative suits and shareholder suits surrounding the alleged backdating and/or timing of stock options by various companies. We believe these filings have already peaked due in large part to statute of limitation issues. At issue in the cases are allegations that companies may have backdated and/or timed options awarded to executives to coincide with the release of favorable news in order to increase the value of those options and that companies may not have properly accounted for and/or disclosed such practices. At this time, it appears that the

resolution of these cases will not result in large payments by directors and officers liability (D&O) insurers, and, thus, the cases should not have a material impact on the D&O market.

Subprime-Related Litigation

The "meltdown" of the subprime credit markets is a potentially significant matter. There is a considerable uncertainty as to the valuation of subprime mortgage-related securities as a result of increasing default rates and the number of ARM resets on the horizon. In addition, the concerns related to subprime mortgage debt have triggered an overall tightening of the credit markets which may have a material adverse impact on many companies' financial statements. The 2007 third quarter's disclosure season may generate some significant stock market volatility as holders of subprime mortgage debt try to mark the securities to market in a very fluid and tight market.

Errors or omissions in those disclosures could ultimately lead to corrective disclosures, subsequent drops in stock prices and the almost-certain securities class action filings as a result. As of November 30, 2007, more than 25 subprime mortgage debt-related suits have been filed against banks, mortgage companies and home builders.

Executive Compensation

Shareholders and the Securities Exchange Commission (SEC) continue to scrutinize executive compensation, particularly with regard to companies that may be performing below expectations. A number of suits have been brought challenging such compensation. Moreover, recent SEC rules requiring more comprehensive disclosure of such compensation may further fuel this trend, particularly if companies cannot demonstrate that their executives met their performance targets.

Foreign Corrupt Practices Act Violations and Investigations

There has been a recent upsurge in enforcement actions alleging violations of the Foreign Corrupt Practices Act (FCPA), a statute passed by Congress in the mid-1970s. The Act prohibits the bribing of foreign officials to gain a business advantage and requires companies to maintain records that accurately represent their transactions and to have an adequate system of internal controls in place. While FCPA violations generally result in criminal punishment, fines, and penalties, which are typically not covered under a company's D&O policy, they can also lead to follow-on civil litigation, such as securities class actions which do implicate coverage.

Climate Related Liabilities

Climate change or global warming is an area that has sparked a great deal of concern among regulators, investors, and public interest groups. Directors and officers who fail to disclose and manage environmental and climate-related concerns and to anticipate and guard against the risks these concerns may pose for their company's financial performance may find themselves at risk for shareholder suits. In addition, the recent adoption of FIN 47 may lead to complexities around identifying, estimating and disclosing environmental liabilities associated with the future retirement of fixed assets. The complexities create a greater potential for eventual corrective disclosures.

During the 2007 proxy season there were approximately 40 climate-related shareholder proposals. Of those proposals, 15 companies addressed the shareholders concerns and had the proposals removed. With respect to the remaining proposals, there was an average 21.6 percent vote by shareholders to support those proposals, highlighting the increased focus by shareholders on issues related to global warming.

Growing Complexity of Current Environment
The environment for D&O litigation has become increasingly complex. Securities class action litigation, once bad news in and of itself, now often comes accompanied by an ERISA stock drop suit, a state law tagalong derivative claim, opt-out claims, and actions by regulators. A regulatory investigation into an issue at a single company may often generate investigatory sweeps of entire industries. This "balkanization" of claims can lead to much higher total settlement values and create enormous challenges in bringing closure to litigation relating to the same issue. In this brave new world issues can arise regarding the structuring of settlements and the timing of proceeds paid, and a global understanding of D&O and how it interacts with other coverages can be crucial.

Claims for Disgorgement or Restitution
D&O policies typically cover "loss" which is defined to include damages, settlements, judgments, interest, and defense costs. Courts have held, however, that not all "damages" assessed against an insured necessarily constitute "loss." There have been a number of judicial decisions in the past several years that have found that damages that essentially involve an order for the defendant to repay monies wrongfully obtained do not constitute insurable loss. In the most recent of these decisions, *CNL Hotels and Resorts v. Houston Casualty and Landmark American*, the court reaffirmed the proposition that settlement for a Section 11 claim, especially one in which only a corporate defendant is named, may not be an insurable loss. By rejecting CNL's argument that the definition of "securities claim" specifically included claims under the Securities Act of 1933, the court cast doubts on efforts to endorse policies to provide specific coverage for certain Section 11 losses which might constitute restitution or disgorgement. Policy wording, including both the definition of "loss" and more recent endorsements specifically designed to address this issue, needs to be reviewed carefully in order to fully understand the scope of available coverages.

Personal Liability in Just For Feet Settlement Highlights Need for Proper Coverage
On April 23, 2007, it was widely reported that four outside directors of Just for Feet Inc. (JFF) settled a claim by JFF's bankruptcy trustee for $41.5 million. As in Enron and WorldCom, the JFF directors were personally liable for this settlement amount. Directors and officers liability (D&O) insurance was not a factor in the JFF settlement because, according to press reports, all but $100,000 of the policy limit was used in settling a shareholder class action based upon the same facts as the bankruptcy trustee's case against the outside directors.