FINAL TRANSCRIPT

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**ACC - Directors and Officers Coverage: Potentials and Pitfalls

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PRESENTATION

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Hi this is Rich Mannella. I'm senior counsel with Total American Services and I'm going to moderate today's web cast of the Association of Corporate Counsel entitled "Directors and Officers Coverage: Potential and Pitfalls".

Before we introduce our presenters, I wanted to share with our audience a few statistics that I gleaned from National Union which is a major directors and officers insurer. Recently saw a national union president speak on directors and officers insurance and flashed some statistics that I think people will be interested in. And it will provide a good backdrop for our presentation today.

One of the things that National Union compiled was a slide indicating that ten years ago the total of the top five securities class action settlements was $350 million. However since the federal securities tort reform there have been at least a dozen settlements of $300 million or more, led of course, by WorldCom at over 6 billion.

National Union also noted that particularly since the enactment of stocks there has been almost a two fold increase in annual restatements. In 2000 there were 233 restatements. In 2004 there were 414. And a third factor that I want our audience to be aware of is that these increasing settlements and incidents which have made companies targets, has not escaped smaller companies.

According to the National Union statistics, 56% of non-financial institutions sued in 2003 have revenues of less than 500 million. Twenty-six percent had revenues of less than 1 million. So, we're seeing bigger settlements, more incidents, which have put pressure on companies and have given fodder for companies to be sued and more companies being targets of law suits, which implicate directors and officers.

And with that background, I'd like to introduce our presenters today. First Jim Reuter is a partner with Lindquist and Vennum. He is a seasoned trial lawyer with extensive practice advising businesses regarding their insurance and representing them in insurance coverage dispute. He's also Lindquist and Vennum's insurance coverage practice group chair and in that capacity the group in addition to litigating coverage matters, provides coverage analysis, risk management advice, and advocacy for policyholders. And they wanted me to emphasize policyholders in various insurance related matters including an area that's becoming an increasingly more important - and you'll hear more about today - the negotiation and purchase of insurance policies.

Mr. Reuter's partner, Bill Michael will also present today. And Mr. Michael is chair of the firms white collar and regulatory defense practice group. He too is an experienced trial lawyer in the areas of white collar and regulatory defense, healthcare fraud, complex internal investigations. He's a former federal prosecutor and he has extensive experience representing individuals and corporations and securities fraud, Sarbanes-Oxley, SEC compliance, money laundering, conspiracy and environmental matters.

In addition, Mr. Michael and others at his firm are the authors of two excellent ACC information packs which sort of tangentially fair on our topic today. One is internal investigations and the other is responding to government investigations.

And speaking of responding to government investigations I'd like to turn the presentation over to Bill and Jim.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Thank you and good afternoon. This is Bill Michael. One of the things with respect to this presentation today that we will try and do as prompt you the audience as to when we are on particular slides. Right now as you can see on slide 2 -- is simply just a picture of Jim and I, the presenters today.

And so without anything further, we will move on to slide 3. Let me just tell you a little bit about why it is that we talked to ACC about doing this presentation. I have found that over the course of the last several years and in my practice in dealing with both the management and also the board of both small, as well as publicly traded companies that ever increasingly there is a very real need and more complex problem associated with D&O coverage.

And in slide 3 we are going to talk a little bit about the need for this D&O coverage and why it is that the D&O coverage is really coming to the forefront on a lot of litigation and quite frankly behind the scenes negotiations for both small companies as well as large ones.

Now we talk about these three bullet points here, first "protecting the assets of the company". In reality the last bullet point subsumes both of the earlier two bullet points. I have found in dealing with boards and also officers or directors who are covered, it is a way of hopefully sharing the financial burden that these investigations encompass.

In essence the investigations that are ongoing have become so financially draining that there needs to be a way - and in fact D&O coverage is a way - to share that pain.

Let's go to slide 4. I want to talk a little bit about some of those financial burdens. Now we all know that governmental investigations under Sarbanes-Oxley have become fairly aggressive. We have an ever increasingly aggressive plaintiff's bar and shareholder litigation. We have requirements for indemnification of officers and employees. Sometimes those indemnifications laws, either by-law or statutes are beyond just directors and officers. But those types of expenses are huge.

Now I want to tell you briefly a little bit about that stuff, because the ability to drain the resources of a company is a very real concern here. I've been involved in a matter where a nationally recognized law firm was doing an internal investigation for a publicly traded company. And it was clear from just the publicly filed documents that this investigation had cost upwards of almost $10 million to do. And that wasn't even getting into the defense debt of these matters.

If you move to slide 5 you'll see some of the things that we're going to be talking about as a way of cost that may in fact be able to be transferred to an insurance policy. You have obviously attorney's fees. And anytime an entity, a corporation, is being looked there is the very real likelihood that there's going to be conflicts involved. And thus, it's not likely to be one set of attorney's fees but multiple sets of attorney's fees. You have experts, depending on what type of investigation it is. You have a tremendous amount of cost.

And quite frankly, some of the costs that are probably the highest are these elect fund costs. Nowadays, with civil litigants as well as criminal investigators demanding the electronic information that's contained within hard drives and servers and shared files and all the rest of it.

The amount of data that one needs to be collected secondly needs to be segregated, then analyzed to determine whether or not its relevant, reviewed for any privilege matters and then ultimately turned over. Those costs are phenomenal and they can easily range into the seven figures. Should there ultimately be a trial whether it's civil or criminal, you have jury consultants. You have travel costs to go out around the country and interview witnesses.

So, the types of costs here are absolutely astronomical even to the small companies. While the numbers may not have quite as many zeros behind them the impact of the bottom line significant. And that's something that has driven me into Jim Reuter's office on many occasions. When I'm representing a director who sits on the audit committee and we need to figure out how best to share the pain, instead of the company. Because the company has six or eight auditors being politely invited down to give testimony to the SEC. Or where there is significant litigation costs associated with the advancement of defense fees in a criminal case.

And so, one of the things that Jim and I really feel is important is that you, the general counsels, get a real sense for why is it going to impact you and what the needs are here. At the end of today's presentation and we encourage you to send email to Rich asking your questions and by the way the very last slide on our presentation when we get to it has our contact information.

So later on if you have a question that hasn't been addressed in this web cast, please feel free to contact either Jim or myself and we'll be happy to try and answer that. But the need for D&O coverage to both small and large corporations is just can not be overstated.

And with that let me turn it over to Jim now to talk you through the policies, what to look for, what not to look for, etc.

James W. Reuter - *Lindquist and Vennum - Partner*

Thanks, Bill. We are to start on slide 6. And trying to think about how to do this in the brief amount of time that we have and do it most efficiently, what we concluded was maybe the best way to look at this is how do you go about purchasing a strong policy. If you know how to do that you're also going to know a lot about the claim issues at the back end.

So starting with the application, a big issue today that we're finding involved in a lot of coverage litigation is, who does the application bind? What you want to do in terms of buying a strong policy is to make sure that the application is severable, that is not imputable to innocent directors and officers. That's become a major issue. Otherwise the general rule is that a policy is rescindable for any material misrepresentation.

Now today given the market that we have, which has been a hard market, but it's softening, which is good news for insurers. But in the past few years insurers have been willing to provide often times only limited severability. Not full severability with respect to the application. Now that's not so true with respect to Side A coverage.

Side-A coverage, covers only the directors and officers, generally speaking. And that has become critical coverage today for directors and officers who are looking to protect themselves individually. Side-Coverage is, provides better severability, usually, has fewer exclusions, exclusions that are more favorable to the insureds.

Believe it or not, the insurance industry says that there hasn't been really that much demand for Side-A coverage. I would suggest to you that's something that ought to be explored by a company of almost any size.

And I would certainly think the individual directors and officers would want to strongly encourage looking at the purchase of Side-A Coverage. A comment going back to severability--.

A common form of, and now we're on to slide 7, by the way. A common form of limited severability except for knowledge of the application signers are certain officers whose knowledge is imputed to all. You may able to better than that with some negotiation at the front end and get a full severability clause which is something like, knowledge of one insured may not be imputed to another insured.

Now, bear in mind that there are tow kinds of basic severability clauses besides the full and the limited. There's the severability as to the application which we have just been talking about and then there's a different severability altogether. And that is the

severability of exclusion and we're going to talk about that later. But please bear in mind that you're going to want as complete a severability clause with respect to both the application and the exclusion. Another thing you're going to want to do with respect to the application is to limit any misrepresentation to actual and knowing fraud. That eliminates a bar to coverage from negligent or even innocent misrepresentation.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Jim, this is Rich Mannella.

James W. Reuter - *Lindquist and Vennum - Partner*

Yeah, Rich.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

On that. Some insurers want the prospective policyholder to attach copies of current SEC filings and annual reports and then purport to make those attached documents a "material part" of the application. My question is, is there a way to get around that so that you can preserve as much coverage?

Or will a carrier allow you to strike certain parts of that, saying we're going to give you this for informational purposes, but we're not including it as part of the application? As a way of trying to limit a problem down the line. If for example you have to restate your earnings.

James W. Reuter - *Lindquist and Vennum - Partner*

Right. That's a good question Rich. That is a very important issue. What the insured, the companies, the businesses should try to do is to -- if you are going to attach publicly filed documents such as documents filed with the SEC. Try to avoid representing that they are included as part of the application and that the insurer may rely upon them. If you have to provide them, provide them. The insurer is going to have access to them anyway, through public sources.

So, go ahead and provide them would be my advice but try to avoid representing that they are incorporated in the policy or that they are accurate or that they will be relied upon the insurer. And I'll actually get into that a little bit later and discuss a little bit later why you might be able to make a distinction there.

Other possible things to think about there is again to buy A Side Coverage or Side-A Coverage. Another thing you can do in that situation is to negotiate with the insurer to add errors or omissions endorsement and with that says is essentially is any unintentional errors or omission made by the insured shall not void or impair the insurance hereunder provided the insured reports such errors or omissions as soon as reasonably possible. Those are some ideas for trying to mitigate the situation you're talking about Rich. And I'll talk about a couple of cases. Or why don't I talk about them right now.

Two important cases to know with respect to the issue that Rich as braised about, attaching essentially SEC documents to the application. The Cutter and Buck vs. Geneses Insurance Company case. And I'm not going to site a whole lot of cases but I'm going to site a few key ones. That site is 306.F.Supp2nd 988, it's the western district of Washington case. That's 306.F.Supp2nd 988. That case had an application with limited severability clauses.

However, the application the court found did incorporate the SEC documents. There was a necessity to restate earnings and revenues, etc. There was a finding that there was some intention on the part at least - I believe it was - the CEO to misrepresent the financial status of the company.

And the court voided ab initio, threw it out entirely, as if it never existed. The insurance policy as to all insureds, which means all directors and officers, even those who are innocent.

Another case that should be contrasted with Cutter and Buck is the Healthsouth case. Which is at 308.FSupp2nd 1253, 308 1253. The program district of Alabama 2004 case. That case involved full severability clauses and there the court found for that reason and for public policy reasons that the severability clause would govern. Even though the insurer was trying to rescind the entire policy arguably including the severability clauses, there the court said no. There was no showing that most of the directors and officers had any knowledge of the problem.

So the message that you take from those cases in comparing and contrasting them is, get full severability, number one. And number two don't try to avoid incorporating the SEC documents in the application.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

This is Bill. One thing I want to point out is that - that having spent a decade on the government side -- it is very, very common for prosecutors and regulators to read the newspapers and read the financial reporting to try to identify particular cases to start investigating.

And it's not uncommon at all; in fact it is extremely common for either prosecutors or SEC lawyers to see that in fact a restatement has been made and use that as the basis to initiate an investigation. Obviously, they're then going to start looking at why those restatements occurred.

And the laws with respect to responsibility, especially from the justice standpoint can be extremely broad. And if in fact there is one individual who had some participation in an improper manner with setting up the financials in such a way that benefited the company later leading to restatements, you certainly don't want to preclude coverage for every single other innocent director and officer. The ramifications are just way too important here.

James W. Reuter - *Lindquist and Vennum - Partner*

Exactly right. Thanks a lot Bill. Continuing at the bottom of slide 7, "conduct due diligence investigation". There's not much I can elaborate on with that. So don't through the application together.

And that seems continued on slide number 8, "respond carefully". State the basis for your response if it is a limited basis that should be stated. We've already talked about incorporation of documents. So I'm going to skip that bullet point and go down to the next one which is distinguish opinions from facts. If your knowledge is incomplete, invite the insurer to investigate further.

And the next two bullet points, "do not warrant information", "do not stipulate to reliance". That's much easier said than done. Every insurance application from a sophisticated D&O carrier is going to have that requirement in it. You can try to negotiate around it or at least limit what it covers. So it doesn't cover for example attachments. But it's going to be difficult to do. Let's see.

Then we are going to go on to the next slide which is number 9, "avoid combination policies". And the only reason I say that is because it dilutes the coverage available under the directors and officers policy. You don't want your employment practice of liability limit being shared with your D&O limit. So that if you bump into it here we've got a lot employment practices claims and they do seem to come in spurts sometimes. You're not going to be diluting the coverage at limits available for your directors and officers.

Who is covered? The traditional coverage - and a lot of people have a difficult time understanding this - but the traditional coverage for D&O policies do not actually cover the business except on a reimbursement basis. They were triggered by the

conduct of the directors and officers. There are still some of those policies around. And they've been tweaked now a little bit and called Side-A Coverage.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

One thing I want to point out here too is that if in fact you've got a claim that has only D&O carriers covered, but in fact the entity also has counsel and is sharing the costs of the investigation. One method of sharing the cost back to the insurance company is to consider entering into a joint defense agreement. Obviously there's a lot of consideration to go into that, but if there are ways of entering into a joint defense agreement and having counsel who are representing for example, directors or officers who are covered, absorb those costs and pass them on to your D&O policy. That can be a tremendous savings to a company that would otherwise have to eat it.

And we've done that often times in the past -- is take a look at how best to save the companies money because in these types of cases. One the D&O policy my ultimately get exhausted anyway and the companies going to have to fund some expenses later on. Or two, it may be able to use those savings for other things that are necessary.

James W. Reuter - *Lindquist and Vennum - Partner*

Okay, "traditional coverage". That is the coverage that provides coverage to the D&O's but not to the business is fertile ground for allocation disputes. There is a requirement in most D&O policies that provides for allocation of both defense costs and any indemnity cost, that is payment for adverse settlements or verdicts.

And the problem under the traditional coverage was that if you had both the corporation, and directors and officers sued, there would be a big fight about what part of defense costs were going to be covered by the insurer. And what parts of indemnity cost are going to be covered by the insurer.

One way that the insurance industry tried to avoid that, was by introducing entity coverage which also covers the company in addition to the directors and officers. And that is the most common coverage today. Some of the allocation disputes. But it dilutes coverage available to the directors and officers.

So for example, if you have separate counsel for directors and officers you have - we're on slide 10 by the way. If you have separate counsel for the directors and officers from the company, the company's counsel is going to be at least in theory and often times in fact, eating into the limits available to directors and officers.

Furthermore, under the entity coverage you can still have allocation disputes not allocation disputes as to parties but allocations disputes as to covered and persons uncovered claims. Entity coverage may also be a problem in bankruptcy. The trustee may assert that the company is entitled to insurance proceeds before the directors and officers if there is a single limit available to both. That argument was made in the Enron case. It ultimately turned to out to be unsuccessful but it cost a lot of time and money and inks in order to get that determination. The way to avoid that probably is to have both entity coverage and Side-A coverage. Side-A coverage would allow for fewer allocation disputes. Like I said before, they are better policies.

Also with respect to who is covered, make sure you get coverage for all subsidiaries. Joint ventures usually require a separate policy, or at least a separate endorsement.

Moving on now to the "retro-date" which is also known as the continuity date, in most policies now.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

And before you are getting into the retro-date. I had a question for you about--. Somebody wanted to know D&O policy covers officers identified only in the corporate by-laws, but they have other persons who are corporate officers. Are they out of luck?

James W. Reuter - *Lindquist and Vennum - Partner*

They probably are if the policy is clear. But it is only duly elected officers or officers mentioned in the by-laws. If the policies clear, other sort of informal officers are probably not going to be covered. If you can come up with an argument based on the language in the policy and of course, as in most of these issues, policy language controls. And that's what you ought to be looking at first of all. You might be able to come up with some argument.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

In your experience how flexibility are the carriers in, for example, modifying a definition of who is a covered officer? You could just say well, can't we just eliminate the identified incorporate by-laws requirement and just have it be the corporate officers, and here's the list?

James W. Reuter - *Lindquist and Vennum - Partner*

Yes, you could. And I think they would probably agree to that. Oftentimes insured's are even defined as employees. Part of the problem with that is you have to bare in mind that insured's also is a term that is used in some exclusions.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Right.

James W. Reuter - *Lindquist and Vennum - Partner*

For example the insured versus insured exclusion. So you have to make that change advisedly recognizing that it may also be taking away some coverage when it comes to reviewing the exclusions. In other words, the exclusions may prohibit or preclude coverage. If you keep adding people as insureds, obviously, the insured vs. insured exclusion is going to apply to a larger universe.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

At that point, you may end up actually restricting your coverage more than you are enhancing it.

James W. Reuter - *Lindquist and Vennum - Partner*

Precisely. I think we are on to slide 11. The retro-date as I call it, still, is important because in claims made policies like almost all D&O policies are today, it restricts coverage to claims that arise after the retro-date.

And the key word is "arise" after the retro-date - not necessarily are made after - or made. But arise after the retro-date and are made - and most often - and reported to the insurer during the policy period. So if you have a claim that is cooking back there for a while and arising, so to speak, but the claim is not made until much later. You might be in a totally different policy period and you better hope that that policy period has a retro-date that goes back before the time the claim arose. One thing to keep in mind with respect to retro-date is to get them back at least as far as common statutes of limitation.

Another consideration with respect to retro-date they become very important when you are switching carriers. Obviously, especially if claims may be coming or are pending, an updated retro-date like you oftentimes get with a new policy may mean that there is going to be a gap in coverage. Ordinarily, if you are a reasonable risk, insurers will negotiate the retro-date with you. But you have got to be aware of the fact that you need to negotiate it. Otherwise, you will likely get a retro-date that is the same as the policy inception date. Which may not help you a whole lot, you are probably going to have a gap in coverage in that situation.

Going on to slide 12, "securities coverage". Is usually excluded unless by special form or endorsement if it is restored. Today it is quite common. Obviously for publicly held companies to have securities coverage added for the company as well as for the directors and officers.

Next point, which is a very important point and alludes back to what Bill was talking about a few minutes ago. Get a broad definition of claim, one that does not include just suits and demands for money. You want a broad definition of claim so that it includes administrative proceedings, regulatory proceedings, investigations even, subpoenas. For example from the SEC. Because as bill pointed out even before the law suit starts or the demand for money is made you may spend - in his case - $8 or $10 million just defending the investigation or complying with the investigation demands.

So it is crucial to get that. Now on the other side, if you've got a broad definition of claim you have to provide notice of claims. And that may broaden your duty to provide notice to the insurance company of claims. Including such things as investigations and subpoenas. So, if you are going to have a broad definition of claim your employees need to understand that they are going to be needing to report a broad spectrum of claims including investigations, subpoena, etc.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

With - Oh, I'm sorry go ahead Rich.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

I was just going to say is there any significant downside to, as we like to say, providing notice like they vote in Chicago, early and often?

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Erring on the side of caution and providing notice as soon as you are aware of some incident or occurrence or some indication that something is coming down the pike.

James W. Reuter - *Lindquist and Vennum - Partner*

Ordinarily not. Clients do get concerned about providing notice. They think that it is going to drive up their premiums, which in most cases is not true. Ordinarily if a carrier non-renews you, you can get coverage from another carrier, at least these days. So that is not a reason not to give notice in my book.

And the only other thing that arises in very unusual situations is if your coverage is going to be changing and getting better in the future. And usually in the near future, if there is some discretion about whether or not - or there is some ambiguity about whether or not there is a "claim" yet you have to at least think about whether or not you want to make - or give notice of that claim under your current policy. Or under maybe a new policy with better terms that might be coming online in a short period of time. But there are risks to doing that, obviously. But it is something to consider. But other than those two situations, I do not see any reason to ever withhold giving notice to an insurance company.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Well, and how you give notice sometimes can be impacted by what you do. For instance that the Department of Justice normally doesn't provide out any sort of formal notice that it is conducting an investigation and therefore in my practice, I've found insurance companies somewhat reluctant to take the position that in fact an investigation is ongoing and they have an obligation to make payments to advance defense costs under the policy. And I've gotten around that in a couple of instances by working with the prosecutor to get what is called a target letter.

And a target is in fact a term of art in the Department of Justice to in essence indicate that either a particular individual or entity is in fact under investigation and is, in essence likely to be charged. Because there is evidence indicating that a crime has taken place. But what we have done in the past in order trigger the D&O coverage is to request a formal target letter from the Department of Justice. Nobody ever wants one of those things with their name on it whether it is a entity or individual. But oftentimes your status is that anyway and it will allow you to then file that target letter with the insurance company, which clearly sets forth that there is an investigation ongoing.

James W. Reuter - *Lindquist and Vennum - Partner*

Yeah, that's a good point Bill. I'm going to move on to "discovery of claims or occurrences". You want a clause in the policy that limits discovery to high officers or to your risk department or insurance department. That is to prevent a situation where a low level employee knows something about a claim or knows there has been a claim.

And the policy the way it is written without a discovery clause would probably impute that notice to the company. It even comes up in situations where there is embezzlement, for example. And the embezzling employee obviously has notice of a claim. Insurers have actually argued that that precludes coverage because the corporation through the embezzling employee itself had notice and did not give timely notice. Which, by the way, is becoming ever more a question they way policies are written these days that that provides timely notice is a condition precedent.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Right. Yes. In addition to D&O policies most policies are now written on a claim made reported basis. It is very difficult to get around those provisions if you didn't provide notice in a timely manner.

On the other hand Bill's point about getting a target letter is excellent because otherwise you are doing this catch 22 position where the insurance company says you didn't give notice and they are not going to pay for your defense costs. But if you wait too long they come back and say, well we are not paying for your pretender defense cost.

James W. Reuter - *Lindquist and Vennum - Partner*

Exactly. Speaking of payment - we are going on to slide 13 now, "order of payment provision". That is a key. You are going to want an order of payment provision to protect your directors and officers under an entity type of policy. It simply provides that if the policy limits are going to be exhausted or it appears that they may be exhausted the individual directors and officers to pay their defense fees and costs and indemnity costs before the company does.

Moving on to the "right to buy a discovery period endorsement or tail" - as it used to be called. It is also sometimes called today, an extended reporting endorsement. Those become very crucial when there are claims popping up and you are going to have difficulty getting renewed or you may get renewed at lesser limits, much greater self insured retention, and those kinds of things. You want the right to buy a discovery period endorsement or tail where a renewal is offered but it is offered on inferior

terms, such as much lower limits or higher self insured retention. The buy endorsement you can usually change. That is by negotiation you can usually change the length of the tail, which oftentimes is one, two or three years.

And the cost of the tail, that is an item that is usually negotiable. The life of the tail in terms of what it ought to be - one of the things to keep in mind is what the statute of limitations is for again, common causes of action that may be asserted against the company.

On to slide 14. I'm going to skip the "notice of circumstances" because we are starting to run short on time. But I will just say that it is fairly common to have such a provision. And if you don't have it in the specimen policy that you are provided with, before you decide to purchase a policy you ought to get it.

Exclusions, that's slide 15. There are a lot of exclusions in D&O policies that oftentimes marketed with a picture of this very restful or sleeping executive - oftentimes in bed. The message being you can rest assured that you are going to be covered, so you don't need to worry about any liability.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

And this is Bill, I will tell you that every director and officer I deal with which is usually those only in trouble because of some investigation, do not sleep easy. The level of stress that comes with any of these investigations that would trigger D&O coverage is phenomenal. Not only to their personal integrity, the credibility of the company, the good will that the company has earned. But also just the threat of the unknown and that resting assured is probably nothing further than the truth in what they are going through during a time like this.

James W. Reuter - *Lindquist and Vennum - Partner*

I thing that if you have Side-A coverage you might be able to close one eye. But certainly if you don't you want to sleep with both eyes open, so to speak. There have been a couple of articles recently in the industry literature - something to the effect - are D&O policies fundamentally flawed. The reason that those articles are asking that question is because there are so many exclusions to the standard D&O policy. So what can you do? And by the way most directors and officers have no idea of what they are not covered for.

So there is a real disconnect oftentimes, after a claim is made, between what the director and officer - especially and outside director and officer - thought they were covered for and what in fact they are covered for.

So what can you do to attempt to mitigate that situation? First of all exclusions that are based on conduct which are the dishonesty exclusion, which is coupled with the fraudulent or criminal conduct exclusion, the personal profit exclusion is a conduct exclusion. Any exclusion that relates to the conduct of the insured director and officer should provide that the applicability of that exclusion is determined by final adjudication. Or if you can't get that which is the best phrase then you want to get the in fact phrase, which would be the second best. Otherwise what you run into is that the mere allegation, for example, of dishonest conduct or fraudulent conduct removes the coverage. You want at least a defense so you want the final adjudication of the dishonesty or fraud before you lose your coverage.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Jim, this is Rich. In practical terms what does that mean. For example does final adjudication mean that your last appeal, your writ of asociality of the United States Supreme Court has been denied or something less? And or in fact exactly what are we talking about that somebody gave deposition testimony under oath that implicates bad conduct?

James W. Reuter - *Lindquist and Vennum - Partner*

Right. Good question. I think that final adjudication means what it says. And that means after the US Supreme Court has disposed of your writ of cert, if that is where it goes. An example of a final adjudication clause is something like this. Their coverage is excluded for acts or omissions arising out of any criminal or fraudulent act if any judgment or final adjudication establishes that such criminal or fraudulent act err or omission occurred.

With respect to the in fact phrase, that is the second best phrase. An example of that would be an act error or omission arising out of in fact, any deliberate or criminal deliberate fraudulent act. The key there is, in fact requires the insurer to prove it. And I don't think unless it is the deposition of the insured themselves or herself that a deposition of somebody else is going to be sufficient under most circumstances to allow the insurer to meet a burden of proof in that respect. So final adjudication means what it says. In fact, means that the insurer must prove that there was deliberate criminal or fraudulent act for example.

William Michael. Let me interrupt for a minute the comment or the phrase that Jim just read about, final adjudications, he read a phrase that talked about judgment or final adjudication. And just so everyone is clear, from a criminal standpoint if in fact the Department of Justice goes after an individual or entity.

And there is a finding of guilt by a jury; the judge ultimately signs a document that is called judgment and commitment order. And it is - in my practice and what I have seen is that insurance companies view that as the decision. And the practical implications of criminal cases are - there is usually one appeal. And that usually goes up the court of appeals and very few cases ultimately work their way even through for cert to the Supreme Court. So that language is crucial to look at to determine whether or not it is going to be all the way up. Or it's just going to be a finding at the district court level that judgment.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Speaking of final adjudication, Bill. John Tanner from Agrift Sibbles (ph) just emailed me saying Ex-HealthSouth, CEO, Richard Scrushy has been acquitted on all counts.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Wow, that's amazing. The jury has been out for a long time which long juries generally mean convictions, at least on some things.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

That's surprising.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Well it looks like whatever costs his insurance D&O carrier paid towards that anticipated $30 million defense, they are not going to be able to reclaim.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Gottcha. Just a little side note.

James W. Reuter - *Lindquist and Vennum - Partner*

Back to the more mundane. On to slide 16, "the insured vs. insured exclusion". This is a major exclusion that many people are not familiar with. The original purpose of the insured vs. insured exclusion was to exclude coverage for friendly lawsuits amongst directors and officers. Where they would cook up some way of essentially trying to get coverage for the company. The insured vs. insured exclusion has gone beyond that though, for sure. Right now it essentially excludes coverage for claims brought by the company or one D&O or employee on one hand against the company; or another D&O or employee, on the other hand.

On to the next slide, the - another diabolical thing about the insured vs. insured exclusion is that if oftentimes also excludes claims brought by shareholders, who are not even directors or officers. Unless the claim is -- and you see it in quotes on the slide -- "instigated and continued totally independent" of essential directors and officers. Or bear in mind that directors and officers is usually defined in the policy also as former directors and officers.

One way you can attempt to mitigate this exclusion is to limit former directors and officers for purposes of this exclusion, limit the definition of directors and officers to those directors and officers who are current directors and officers or who have been former directors and officers for example two or three years.

So you don't have somebody that has been off the board for example, for quite a few years being involved in litigation, and losing your coverage through that. Now the courts upheld with respect to the insured vs. insured exclusion that there must be susceptive cooperation by one of the insureds that is being called to testify, for example, will not qualify. This exclusion also with creative arguments can be turned into what may be more of an allocation provision than a total preclusion provision. And we don't really have time to get into that so much. But there are some ways to try to argue around this exclusion in litigation.

But what about before you get to litigation, on slide 18,"the card backs" (ph). The best D&O policies that I have seen usually have five card backs and that is exceptions to the insured vs. insured exclusion that restore coverage. One of those is for a claim brought by a past executive who is not a director or officer as indicated on the slide.

Another one of the five card backs that you should negotiate for is a claim by a bankruptcy trustee or receiver of the like. Who can also for purposes of this exclusion, if you don't have the card backs be treated as an insured. And therefore they would be coverage precluded when the bankruptcy trustee sues directors and officers or the company. Unless you have a card back. There is also card backs for claims of contribution and claims that are outside the United States essentially. That's sort of simplifying them but that's some of the other card backs.

With respect to other exclusions. Other common exclusions on slide 19. Remember with respect to exclusions in general that most of the exclusions are composed of undefined terms. And if they are too ambiguous they are going to be construed against the company. Now we are talking about obviously after the claim is in a situation. The insured has the burden of establishing the applicability of an exclusion and it is going to be strictly enforced - or strictly construed against the insurer. So the insured does have some tools to quiver with respect to battling exclusions and their applicability.

With respect to the dishonest exclusion which is one of the conduct exclusions. Courts have generally held that means intentional dishonesty and knowing criminal acts. With respect to personal profit or advantage, generally that means illegal personal profit or advantage of course. That, the insured could be required by the law to return. I'm not going to talk about the other exclusions because I touched on securities and takeover and bribes esoteric enough I guess that I'm not going to deal with them since we are running out of time.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Let me just comment briefly about the exclusion concerning the white collar crime matters alluded too in slide 19. Often what happens here from a practical standpoint is that the D&O carrier reluctantly agrees to start advancing defense costs after a significant amount of negotiation takes place. Those defense costs whether they are for the entity because the indemnity

coverage or the individuals are paid up until the time that entity or the individual ultimately makes an agreement or is found guilty. And then that usually is going to stop things.

So for instance if I have an individual officer that I'm representing and we sign a plea agreement, agreeing to plea guilty, it's obviously fact dependent on the language of the D&O carrier. But one of the things that is commonly looked at, at that point is that D&O carriers are no longer going to cover from that point forward. And then there are going to be issues about right of reimbursement that I know Jim's going to talk about briefly in a few minutes. So, I'll let him move on.

James W. Reuter - *Lindquist and Vennum - Partner*

Slide 20, "severability clause as to exclusions". It's absolutely imperative in this date and age that you have such a severability clause in your policy. So that the bad acts of one insured are not imputed to the innocent insured. There is an example of such a severability clause. The last bullet point on slide 20. It's -- I can't emphasize that enough.

Moving on to slide 21, "the definition of loss". Which is not really an exclusion, but in practical effect it is. It often acts that way. Restitution may not be covered. That depends on policy language and on the cases in your state or in the state whose laws are going to govern.

No coverage oftentimes for fines, penalties, taxes, some punitive damages -- that varies greatly by state -- for the multiplied portion of multiple damages. Keep these things in mind when you are talking about - when you're thinking about selection of counsel too. And who has the right to select counsel. Because all those exclusion in effect are contained in the definition of loss, increase the interest of the insured in the litigation. And decrease the interest of the insurer and therefore are good fodder for argument with the insurer that the insured has the right to select counsel if some of the alleged damages are going to fall into the excluded part under the definition of loss that is fines, penalties, taxes, etc.

Speaking of punitive damages, on slide 22, "try for most favorable venue endorsement". So that you get the most favorable law applicable. So you don't run into a state that is very strict with its law with respect to certain damages being on the policy. I want to mention something about a resource that is available too that might be quite helpful actually.

Unfortunately, I don't know the publisher right now. But it's something that I have a subscription to and it's called the Betterly Report. They regularly obtain information from all kinds of insurers. They do some coverage comparison, some coverage analysis and even indicate for example, D&O limits that are usually purchased by the carriers insured by the size of the insured in terms of annual sales.

For those of you that might be having some difficulty in getting a grip on how much coverage you should have. Which nobody quite frankly can really answer except for the insured ultimately. The Betterly Report comes out, I believe quarterly. And it takes a particular line of insurance such as D&O insurance one quarter and the next insurance it will be employment practice liability and the next one commercial/general liability policies, etc. But it can be a very helpful source. And it's not real long. It's usually only about 30 or 40 pages long.

Okay, moving to the next subject and actually the bottom bullet point on 22. Should have been I guess on 23, but "selection of defense counsel". With D&O policies and claims made policies usually are also wasting policies so that means the defense costs erode the limits and therefore in effect you are paying for defense counsel. Shouldn't you have the right to select them? Push back on this issue with insurers.

Oftentimes they will be flexible about selection of defense counsel. The situation where their most inflexible is if there is a panel counsel requirement. But our experience is push back, be familiar with the factors that the courts have looked at to determine who has the right to select defense counsel. Including whether or not the insurer has reserved right, how much of the claim are covered or not covered, the distance between the facts in the coverage case and the main case. That is whether the opportunity

for manipulation of the facts consciously or unconsciously by defense counsel to shift the evidence, so to speak, so that it tends to go to uncovered count.

Other conflicts between multiple insured that are constringent cost containment guide lines. Does the nominated counsel, nominated by the insurance company to serve as counsel match the plaintiff's counsel expertise? The insured has the right to have a match. There is a lot of factors looked at by a lot of different states to determine what's the size of the self retention for example is another one. But there are many factors to look at that you should be familiar with those factors. You should push back if you don't like the insurer's selection of defense counsel.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Jim, I've seen a provision in policies where the policyholder gets the right to select counsel with the consent of the insurer, which consent shall not be unreasonably withheld. And what you end up getting into is, you can have your counsel instead of the one we would have selected. But because we have special deals with our counsel we are only going to pay the hourly rate we would have paid our counsel. But you can use your counsel and pick up the difference.

James W. Reuter - *Lindquist and Vennum - Partner*

Yes, we are seeing those kinds of clauses where the insured does have the right to select counsel subject to approval from the insurance company. I would suggest obviously that you try to get such a clause included in your policy. With respect to the fees part, Rich, the policy does not specify what rates are going to paid for the defense, therefore, my argument is that, that's going to be governed by what are reasonable rates and presumably your own counsel is charging reasonable rates. But that is something that can be subject to negotiation with insurance companies too.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Right. And I've been successful along those lines. It just adds another wrinkle to it. And it again depends on some of the other factors involved, including the complexity of the matter, the potential exposures that are involved. All those things, the self insured retention amount --

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James W. Reuter - *Lindquist and Vennum - Partner*

Exactly, and some insurers for example, National Union AIG, has many form of policies that provide for panel counsel requirements but only with respect to securities claims. So, there is all kinds of different structures out there.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Right. So, and one of the things that we've seen here is a case where the client wanted our firm and panel counsel was the choice of counsel from the insurance company. And quite frankly they stated the reason being was that panel counsel had agreed not to sue the insurance company. And so there are perhaps not just the stated reasons why insurance companies want, but often times unstated.

At least in one case they at least acknowledged those unstated reasons. And I think that it's important because you can push back and Jim's correct. You can in fact some times have different counsel for different things. We've often or at least on occasion had counsel that is not panel representing, for example, on a criminal investigation and panel counsel representing in the class action shareholder suit that's arising out of the same action. So, don't just automatically give up to the insurance companies whims.

James W. Reuter - *Lindquist and Vennum - Partner*

On slide 24 further with respect to defense counsel. We suggest if you do end up with defense counsel at least, defense counsel initially nominated by the insurance company. That you follow some of the suggestions on slide 24 and instruct defense counsel not to prejudice coverage.

And to in fact strengthen the case of coverage not to do things like motion for summary judgment on the only covered count, leaving the uncovered counts still in the case which we see from time to time. That attorney even though he is being paid by the insurance company, the court owes the ethical duties to the company, to the insured. And therefore it is our position that the counsel can be instructed accordingly. Rich, I'm ready to talk about rescission, but I think we are nearly out of time.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Apparently so. It looks like I wanted to remind you guys to please give your email address so that people can email questions to you and follow-up since we are running out of time. And while you are doing that I have one question I'm getting ready to ask you that I got in. That involves since we are all in-house counsel question came in do you advise in-house counsel's specifically vice presidents general counsel. And I'm taking from that question the person wears two hats, maybe an officer and also is acting as a legal advisor. That person in the position of vice president and in general counsel also obtain legal malpractice coverage are they safe in relying on D&O and E&O company coverages?

James W. Reuter - *Lindquist and Vennum - Partner*

Oh boy -

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Can they go partly to what the allegations are? May be depending on which had that person is wearing.

James W. Reuter - *Lindquist and Vennum - Partner*

You know I have never been in in-house counsel. I do not know -- what is common or standard practice with respect to malpractice coverage.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

I will forward this email to you guys and you can think about is some more and respond to the questioner.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Okay.

James W. Reuter - *Lindquist and Vennum - Partner*

Yeah.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Would you again repeat your contact information since we did run out of time and there will probably be follow-up questions.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Be happy to. First of all the contact information is on the last slide of the PowerPoint presentation. But Jim Reuter can be reached at jreuter@lindquist.com and I can reached at wmichael@lindquist.com.

And one thing and I know that it's about ten after and we were told not to run beyond ten after or thereabouts. So I do want to just on behalf of Jim and I thank the audience for listening in. This is a subject that quite frankly the regulatory defense and white collar practice groups throughout the country are seeing on an absolute daily basis. Boards of directors have to be aware of their coverage. It is important issues. It is extremely important to the financial integrity and financial stability if you will, of the companies. Jim and I both would encourage anyone if you have follow-up questions to either give us a call and our phone numbers are on the contact sheet or email us. And Rich, thank you very much for moderating. We appreciate it very much.

Richard Mannella - *Arkema Inc./Total American Services, Inc. - Senior Counsel*

Well, thank you. I enjoyed this and I've learned some things today as well. And again, people this web cast will be available for replay through the ACC website probably as soon as 30 minutes after we end this. And then I think for one year thereafter. So if you want to listen to it again or if somebody you know would like to listen to it we encourage you to go ahead and click on it on the ACC website.

James W. Reuter - *Lindquist and Vennum - Partner*

Thanks Rich.

William Michael - *Lindquist and Vennum - Chairman, White Collar and Regulatory Defense Practice Group*

Thank you.
