

Glossary of Directors & Officers Liability Terms

Advancement of Defense Expenses: This condition requires the Insurer to advance the defense costs of a claim, prior to final disposition of a covered Claim, after the Retention has been fully paid by the Insured. This clause is often triggered by the Insured providing a written request to the Insurer to advance the defense costs.

Allocation: The process with which the Insurer assesses the portion of a claim that is covered. There are three kinds of Allocation that may be made during the claims process: (1) covered vs. uncovered Insureds [i.e. Corporate Entity vs. Directors & Officers], (2) covered vs. uncovered Directors & Officers for acts committed in their *capacity* as D's & O's of the Corporation (i.e. acts as D or O vs. acts as a Shareholder) (3) covered vs. uncovered claims within one lawsuit (i.e. claims with multiple allegations that involve allegations that are covered vs. specifically excluded) The Allocation of a claim will normally involve both the Defense Costs and Loss/Judgements.

Arbitration Clause: The Arbitration Clause provides the Insured with an Alternative Dispute Resolution (ADR) procedure for circumstances when the Insured and Insurer have a dispute with regards to coverage. ADR involved an impartial third party arbitrating the matter between the two parties.

Acquisition Provision: Most D&O policies have a provision that address situations when the Insured is going to acquire or merge another company into the Parent Company as a new subsidiary. The provision normally states the policy will automatically cover all newly acquired subsidiaries that do not exceed a specified asset threshold. (The asset threshold is compared with the total assets of the Parent Company) The asset threshold percentage varies by carrier and normally ranges between 10% to 35%. In addition, there may also be a 30 to 90 day window of automatic coverage for acquired entities that exceed the prescribed asset threshold.

Bankruptcy Exclusion: This provision excludes any claim based upon or arising out of suits related to or brought by or on behalf of the bankruptcy or insolvency of the Company, made by creditors or directly or indirectly resulting from the Insured filing for bankruptcy under any Federal or State Bankruptcy Laws. This exclusion is becoming more common due to the financial deterioration of many companies.

Bi-Lateral Discovery: This provision allows the insured to choose to elect the extended reporting provision/discovery provision either if the insured cancels or non-renews the policy or the insurer cancels or non-renews the policy.

“Bump Up Exclusion”/Inadequate Consideration Exclusion: This exclusion precludes coverage for claims arising out of the Insured’s alleged payment of an inadequate price for the purchase of its own securities. Often coverage can be modified to provide coverage for the Defense of the Claim.

Captive Insurance Company Exclusion: A common exclusion that excludes claims arising out of the Insured’s direct ownership, operation or maintenance of a Captive Insurance Company.

Change of Control Provision: This provision may also be called a Run-Off Provision in the D&O policy. Certain transactions (such as the acquisition of the Insured by another company or change in the ownership) will cause the policy to cease with respect to Wrongful Acts occurring after the transaction date; but will provide coverage for acts that occurred prior to the transaction up to the actual expiration of the policy. Longer periods or Extended Reporting Provisions can be negotiated for additional premium.

Claim (as defined in policy): The definition of Claim in the policy provides clarification for what types of situations will trigger coverage. A broad definition allows the insured to trigger coverage for more situations. For example, Claim *may* include, Oral Demands, Written Demands, Civil Proceedings, Criminal Proceedings, Arbitration Proceedings, Administrative Proceedings, etc. This is a very important definition to review in a D&O policy.

Commissions or Payments/Disbursements Exclusion: This excludes claims arising from payments of gratuities, benefits, and other favors to foreign and domestic governments, as well as political contributions. The intent of the exclusion is to eliminate coverage for payments prohibited by the Foreign Corrupt Practices Act. This exclusion may be deleted with additional underwriting information.

Corporate Reimbursement Retention: This is the dollar amount of defense costs and/or damages that the insured must bear, prior to indemnity from the insurer, for actions that are indemnifiable by the Insured for Claims against the Directors & Officers. There may be separate Retention amounts for Claims for Securities Wrongful Acts vs. Non-Securities Wrongful Acts. The Retention applies to each Claim made against the Insureds.

Coverage Territory: This provision will define the scope of the covered territory. Some policies will provide coverage for claims made anywhere in the world; but only if the suit is brought in the U.S., its Possessions or Canada. Other policies will provide coverage for claims made and brought anywhere in the world.

Creditor Exclusion: This exclusion precludes coverage for claims brought by Creditors, such as, Banks, Finance Companies or any other person or entity that has extended credit to the Insured.

Derivative Suit: This is a lawsuit brought by shareholders against the Directors & Officers of the Corporation; but the suit is brought on behalf of the Corporation.

Employment Practices Liability Endorsement: This endorsement extends coverage to the Directors & Officers (and sometimes the employees) for allegations related to Wrongful Termination, Harassment, Discrimination or other Employment Acts. In some circumstances, for an additional premium, the policy can be extended to include the Corporate Entity.

Entity Coverage for Private Companies: Private Companies have coverage available for the Corporate Entity most mostly all types of D&O Claims. The Entity Coverage normally extends to traditional D&O claims; but also include Employment Practices Liability claims. Many policies will have several exclusions for the Entity, such as Contractual Claim, Anti-Trust Claims, or Intellectual Property/Patent Infringement Claims. It is important to review policies carefully to see which exclusions apply.

Entity Coverage for Securities Claims: Historically, Directors & Officers Liability Insurance was written with the intent to cover only the individual Directors & Officers of the Corporation. Coverage was not provided for claims made against the Corporate Entity. During the claims process, the Insured and Insurer would often negotiate an **Allocation** of the Defense Costs and Damages to determine how much of the claim was covered under the policy. The Insured and Insurer would determine the proportionate liability of the insured Directors & Officers and the uninsured Entity and pay the Insured that portion of the claim against the Directors & Officers. Some recent court decisions have resulted in great advances in coverage. Coverage for the Corporate Entity is now available from most insurers. For publicly traded companies, the Entity Coverage is only available for Securities Claims.

Foreign Equivalents Coverage: This wording broadens the definition of Insured Person to include those individuals in foreign countries that hold positions that are the equivalent of a Director or Officer in the United States.

Failure to Maintain Insurance Exclusion: This exclusion intends to exclude claims based upon and arising out of the failure to effect and maintain adequate insurance by the Insured. This exclusion may be deleted with a schedule of the Insured's insurance or may not exist in the policy at all. This exclusion is becoming more common, especially post Sept. 11th.

Fraud Exclusion: This exclusion intends to exclude claims based upon or arising out of the Dishonest or Fraudulent Acts and/or Willful Violations of the Law by an Insured Person. There are several variations of the exclusion. Some exclusions will defend the insured up until there is factual information (**in fact wording**) proving the dishonest/fraudulent act and other policies will defend until a court adjudicates (**final adjudication wording**) the dishonest/fraudulent act to have occurred.

Greenmail Exclusion: Excludes claims arising from the purchase of the organization's own stock at above-market prices. Greenmail situations are an attempt to resist a corporate takeover. Many claims arise from mergers and acquisitions.

"Hammer Clause"/ Settlement Provision: This section of the policy explains that the Insurer may settle claims; but with the written consent of the Insured. However, the Settlement

Provision usually stipulates that if the Insured does not consent to the Insurer's settlement that the Insurer does not have to pay for any Loss or Defense Expense that exceeds the amount of the Insurer's original settlement. The remaining Loss and Defense Expenses are to be born by the Insured. In some cases, Insurers will agree to a modified Settlement Provision that allows for a Co-Insurance Provision. The Co-Insurance amount can range from a 50%/50% split to the Insurer agreeing to waive the provision in entirety.

Hostile Takeover Exclusion: This exclusion precludes coverage for claims arising from attempts to acquire the Parent Company and from efforts to resist the takeover attempt. The takeover attempt is usually one that is not desired by the Board or Management.

Initial Public Offering (IPO): The first time a company sells stock to the public. The federal and state securities laws govern IPO's.

Initial Public Offering Exclusion (IPO Exclusion): Excludes claims based upon or arising out of the Initial Public Offering of Securities. This exclusion is often placed on policies for privately held companies.

Insured vs. Insured Exclusion: Excludes claims brought by or on behalf of Insureds under the policy against other Insureds. This exclusion can often be modified to carve back coverage for Derivative Claims, Cross Claims and Employment Practices Liability Claims and in some cases suits brought by Bankruptcy Trustees.

Insuring Agreement A: (Individual Coverage) This Insuring Agreement provides coverage to the individual Directors & Officers for claims that are not indemnified by the Insured Company pursuant to the by-laws, statute or due to financial inability. Typically, there will be no Retention for this Insuring Agreement, unless otherwise required by state law.

Insuring Agreement B: (Corporate Reimbursement Coverage) This Insuring Agreement provides coverage to the Insured Company when it has indemnified its Directors & Officers. This coverage part usually carries a significant Retention.

Major Shareholder Exclusion: This exclusion may be added to a policy by endorsement to the policy. This exclusion precludes coverage for claims brought by shareholders that own a certain prescribed percentage of the Company's stock. (Normally 5% or 10% or more) This exclusion may often be deleted by request or with additional underwriting information.

Management Buyout Exclusion: This precludes coverage for claims based upon or arising out of the sale of the Company to any of its Directors, Officers or Employees of the Company.

Non-Cancelable Policy: Some policies will have a clause that states the policy cannot be canceled mid-term, except for circumstances when the Insured has not paid the premium.

Notice of Circumstance/Potential Claims: Most policies have a provision for reporting to the Insurer any circumstances that may give rise to a claim under the policy. This allows the Insured to report events that they think may reasonably give rise to a future claim. The notice requirement may differ between policy forms.

Notice of Claim: This provision of the policy states the required time to report claims to the Insurer. Some policies require reporting of claims with a time period of 30, 60 or 90 days from the date the claim was made against the insured and must be reported within the policy period. Other policies will allow for the claim to be reported 30, 60 or 90 days after the policy has expired. Several policies allow for the claim to be reported “as soon as practicable” with no prescribed time limit to report the claim.

Order of Payments/Priority of Payments Wording: This provision states that the Directors & Officers are provided with priority for payment of claims when the Directors, Officers & the Corporation are all named in the suit and there is not enough insurance proceeds to cover the total amount of damages.

Outside Directorship Liability Coverage (ODL): This extension provides coverage for situations in which the Company and its Board has specifically requested that a Director or Officer sit on the board of another Outside Entity. Coverage is normally extended to non-profit organizations, [traditionally only 501 (c) (3) tax exempt organizations]; but can also be extended to include, on a limited basis, for-profit boards. The coverage normally only applies to that individual and only excess of any indemnity and insurance available from the Outside Entity.

Outside Entity: An organization, as defined in the policy form [normally a non-profit entity] on which a Director or Officer of the Company has a board seat. The Director or Officer must be specifically requested by the Company to sit on this board.

Panel Counsel: A panel of law firms established by the Insurer to defend claims on behalf of the policy holder. The panel is usually comprised of law firms with special skills in a particular area of law, such as Securities Law.

“Pay On Behalf Of” Wording: Most current D&O policies state in the Insuring Agreement that the Insurer will pay the claims, for covered losses, directly to the Insured. Older policy forms used to Reimburse the Insured for the claim.

Pre-Determined Allocation (for Securities Related Claims): This provides a pre-established Allocation or apportionment of coverage between the insured Directors & Officers and the un-insured Corporation in Securities Related Claims. The Allocation is a pre-

determined percentage of loss that will automatically be paid regardless of the actual liability of the covered and uncovered defendants. Without Entity Coverage, this is necessary for insureds so they will not have to dispute coverage with the insurer. The percentage allocation may be anywhere from 60% to 100%. This option is not normally offered in today's environment with Entity Coverage so commonly available.

Prior Acts Exclusion: This exclusion precludes coverage for Wrongful Acts that have occurred prior to the Retroactive Date quoted or in some cases the Inception Date of the Policy.

Prior & Pending Litigation Exclusion: This exclusion precludes coverage for claims arising from litigation of any nature that existed prior to the inception of the policy period. Renewal policies will often have an endorsement that backdates coverage back to the inception date of the first policy written with the current insurer. It is desirable, if possible, to get any new carriers quoting to agree to backdate the prior & pending litigation date to provide Continuity of Coverage.

Professional Liability/E & O Exclusion: This exclusion precludes coverage for claims arising from any rendering or failure to render professional services for others for a fee. It is possible to have a carrier modify the exclusion to provide a Management Carveback wording to provide coverage for claims alleging mismanagement and failure to supervise.

Punitive Damages: Directors & Officers policies will either be silent on coverage, specifically exclude coverage or specifically provide coverage for Punitive Damages. Many policies today will provide some form of coverage for Punitive Damages. Coverage can come in many forms. Some policies will only cover Punitive Damages for Securities Claims. Others will provide coverage only where it is legally insurable. Still others will provide a recently developed "most favorable venue" or "most favorable jurisdiction" version of coverage. Every policy varies with respect to the extent of coverage for Punitive Damages.

Regulatory Exclusion: Excludes coverage for suits brought by regulatory agencies, such as the FDIC, OTS or other regulatory authority. In the late 1980's it was common to see the banking authorities file suits against the Directors & Officers for mismanagement of the Financial Institution. This exclusion normally applies to Financial Institution accounts. [Banks, Insurance Companies, etc.]

Retroactive Date (Retro-Date): This is a date in which any Wrongful Act occurs prior to this date is not covered under the policy. Any claim made for a Wrongful Act that occurs after this date is covered under the policy.

Secondary Offering Exclusion: This exclusion precludes coverage for claims based upon or arising out of additional public offerings made after the Initial Public Offering (IPO). Normally,

the exclusion will allow for a prescribed window of 30 or 60 days to report the Secondary Offering to the underwriter. The underwriter also has the right to charge an additional premium and/or modify the terms & conditions.

Securities Class Action: A securities class action is a case brought pursuant to Federal Rule of Civil Procedure 23 on behalf of a group of persons who purchased the securities of a particular company during a specified period of time. [the class period] The complaint normally contains allegations that the company and/or its Directors & Officers violated one or more of the federal or state securities laws.

Securities Claim: A definition in the policy that describes what types of claims are covered related the company's publicly traded shares. The definition comes in many forms; but generally states that it covers violations of the Securities Acts of 1933 and 1934, any federal or state statute [including "Blue Sky Laws"] and any acts, errors or omissions in connection with the purchase or sale of any securities issued by the Company.

Severability of the Application: This provision states that statements and particulars contained in the application for insurance will not be imputed to one Insured Person if another Insured Person made a false, misleading or untrue statement in the application. This will prevent the policy from being voided by the carrier for those individuals that did not make the false, misleading or untrue statement(s) in cases where the insured misrepresented information contained in the application. Normally, the policy will be voided as respects the individual that made the false, misleading or untrue statement in the application. In some cases, the whole policy can be voided if the person that signed the application made a false, misleading or untrue statement.

Severability of Exclusions: This provision states that the policy will not impute the conduct of any Insured Person to any other Insured person with respect to the application of the Exclusions. [either certain exclusions or all of the exclusions] This means that the exclusions will not be applied to any Insured Person that did not commit the Wrongful Act. Some policies only provide severability for the Fraud, Personal Profit and Insider Trading Exclusions. While other policies will provide severability with respects to all of the exclusions in the policy.

Specific Entity or Parent Company Exclusion Exclusion: This exclusion precludes coverage for Claims made by a specific corporate entity due to a special relationship, such as major shareholder or parent company.

Spousal/Marital Estates Coverage Extension: This provision provides coverage for Claims made against the Spouse or Estate of the an Insured Director or Officer due to the Wrongful Act of the Director or Officer. Coverage is not provided for Wrongful Act made by the Spouse.

Waiver of Retentions/Retention Enhancements Provision: This is an enhancement that states the Retention will not apply to Securities Claims for Loss. Often the policy will state that Defense Expenses will be applied to the Retention; but they will be reimbursed upon the determination of No Liability. Most carriers have begun to delete this coverage feature from their policy form, due to the tightening D&O market.