

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

NEWSLETTER

Volume 8, Issue 1: Fall 2003

WHY NOTIFYING INSURERS OF CLAIMS IS ALMOST ALWAYS THE RIGHT DECISION

In a “hard market” many brokers and risk managers suggest that policyholders would be better off not giving notice to their insurers of claims, even if they are potentially covered, so as to avoid higher renewal costs. There are a number of problems with this approach. Five concerns are addressed hereafter.

First, if the policy has a “voluntary payments” provision, the failure to provide notice will bar



recovery of pre-notice attorneys’ fees and may preclude a right to recover any policy benefits if the notice is delayed until trial is imminent. This result may attend even in the majority of jurisdictions that require an insurer to prove prejudice to avoid policy benefits. If the policy is “claims made” (i.e., E&O/D&O) as opposed to “occurrence” based (i.e., CGL/Umbrella), the failure to provide notice of ongoing litigation during the policy period could impact the ability to obtain any coverage.

Second, in the event that the suit leads to a damages award or a sizeable settlement, and these exposures are not covered by insurance because no proper or timely notice was given, such a corporate loss could create a basis for a shareholders’ derivative action against the corporation for “waste” of the insurance policy asset.

Third, many insurers learn about ongoing litigation because it is reported on 10Q or 10K forms filed by

the corporation as public records or because all outstanding litigation is reported in D&O renewal applications. Many insurers will already have taken these claims into account and adjusted

GAUNTLETT & ASSOCIATES THE POLICYHOLDER ADVOCATE

We specialize in policyholder insurance coverage and litigation re patent, trademark, copyright, trade secret, business, labor, environmental, and antitrust disputes

Specific services offered include:

1. *Insurance coverage focusing on IP and Antitrust Claims*
2. *IP litigation*
3. *Expert witness on ins. coverage issues, including fee disputes*
4. *Counsel to IP case-in-chief counsel for ins. coverage, including:*
 - *Choice of forum, and*
 - *Negotiation*
5. *Consultant to corporations regarding what type of policies to purchase to protect against IP litigation*
6. *Representation in arbitrations and mediations*
7. *Legal malpractice defense - as expert and percipient witness*

If you have a topic you would like to see addressed in future issues, please feel free to contact us with your suggestions.

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In This Issue

WHY NOTIFYING INSURERS OF CLAIMS IS ALMOST ALWAYS THE RIGHT DECISION Page 1

INDEPENDENT DIRECTOR EXPOSURE TO POST SARBANES-OXLEY CLAIMS REQUIRES REVISITATION OF DIRECTORS & OFFICERS INSURANCE COVERAGE Page 2

PUBLICATIONS BY DAVID A. GAUNTLETT Page 4

SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY Page 4

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

insurance premiums accordingly. Thus, policyholders will suffer the consequences of reported litigation without obtaining any of the policy benefits which prompt notice would have secured.

Fourth, insurers typically assert that they want notice of all litigation against the company to better assess its risk profile. Brokers and risk managers who suggest that notice to the carrier will raise rates are often speculating. A loss, not a mere claim, is the event typically tracked by most insurers in fixing higher premiums. A risk manager would be hard pressed in a “waste” action to explain why it believed premiums would be higher where there is no tangible evidence that such would be the case. Reliance on a broker’s oral statements to that effect, where that broker did not investigate to see precisely what premium increases would have arisen if notice were provided, is not competent evidence. Even favorable testimony from the broker as to its reasonable expectation that higher premiums would result may provide little comfort to such a corporate policyholder, especially where more diligent inquiry would have revealed even broader replacement insurance coverage at an equivalent or even more favorable price point.

Fifth, in virtually every case, the recoupment of significant fees incurred in intellectual property/antitrust/unfair competition actions significantly outweighs the premium costs that may arise from procuring insurance to cover future claims.

For these and other reasons, unless the policyholder has only one insurance market where it can procure,

on an “occurrence” basis, acceptable insurance coverage, there are rarely circumstances where the failure to give notice makes economic sense.

INDEPENDENT DIRECTOR EXPOSURE TO POST SARBANES-OXLEY CLAIMS REQUIRES REVISITATION OF DIRECTORS & OFFICERS INSURANCE COVERAGE

I. INTRODUCTION

Most Directors & Officers policies include a number of new exclusions. The most troublesome is the “severance” clause which precludes innocent directors and officers from procuring policy benefits where other directors and officers are found liable for wrongful acts in shareholder derivative lawsuits or governmental lawsuits.

Directors and officers, however, need not put their own personal assets at risk. New forms of insurance, like that offered by ACE through its CODA program, offer individual directors independent insurance opportunities that are far more comprehensive in coverage than that offered through the corporation.

These policies should be procured by directors and officers as part of their compensation for taking on the risks associated with serving as an officer or director of public corporations in the new hostile environment. This is especially the case where the Sarbanes-Oxley provisions make procedural compliance critical and where directors, even those highly informed

about the company’s operations, may not be able to assure proper procedures are followed in each and every situation. Protection against exposure from these risks is essential, especially for directors who sit on audit committees.

II. INDEPENDENT D & O POLICY COMPARISON

A. Standard D&O Policy

**AIG - National Union Fire
Insurance Co. of Pittsburgh**
www.aig.com/directorsofficers

Features:

- Limit of liability eroded by coverage for company indemnification and securities claims against company;
- Exclusions relating to pollution and ERISA violations;
- Exclusion for most claims brought by or on behalf of company or any D&Os (i.e., “insured v. insured” exclusion);
- Exclusions for fraud, dishonesty, willful violations of law, or illegal remuneration;
- Policy may be rescinded if company restates financial statements included in application;
- Large deductible (at least six figures) applies to D&Os if company wrongfully fails to indemnify D&Os;
- Policy cancellable by insurer;

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

- Policy may be an asset of company's bankruptcy estate, in which case policy proceeds cannot be accessed by D&Os without bankruptcy court approval.

B. Independent Director Policy Providers

1. ACE Insurance Company CODA - A Subsidiary of ACE Independent Director Policy

www.acelimited.com

Features:

- Limit of liability eroded only by coverage for non-indemnified loss of outside directors;
- No pollution or ERISA exclusions; bodily injury/property damage exclusion not applicable to pollution claims;
- "Insured v. insured" exclusion applies only to claims brought by or on behalf of company with the assistance of at least two senior executives; exclusion not applicable to (1) claims by or on behalf of D&Os, (2) claims outside the U.S. or Canada, or (3) claims made after a change in control;
- No exclusion for fraud, dishonesty, willful violations of law, or illegal remuneration;
- Policy cannot be rescinded based upon restatement of financial statements;

- No deductible applies to D&Os even if company wrongfully fails to indemnify D&Os;
- Policy not cancellable by insurer;
- Policy not an asset of company's bankruptcy estate, and policy proceeds are immediately available after bankruptcy filing.

2. Chubb Personal Director's Liability Ins.

www.chubb.com

Features:

- Protects the insured's personal assets for independent directorship that he or she chooses to designate for insurance purposes;
- Protection designed solely for the insured person;
- Broad definition of directorship;
- Insured directorship can be at publicly traded, privately owned, or nonprofit corporations;
- Tailored coverage;
- Coverage applies for loss excess of any other insurance and indemnification from any source but before an insured taps into his or her own assets. This can occur when the underlying insurance is financially unable to pay, has been rescinded, or coverage is precluded by breach of a nonseverable warranty or is

deemed part of the corporations's bankruptcy estate and the corporation is unable to indemnify;

- Policy applies on an excess basis over existing D&O liability insurance coverage. In the event indemnification is unavailable, and the underlying D&O liability coverage proves to be uncollectible, then Chubb's policy drops down;
- Freedom to choose defense counsel;
- Spousal coverage included – policy insures executives, as well as their spouses or domestic partners if they are named as co-defendants;
- Policy limits of up to \$10 million available.

3. AIG - National Union Fire Insurance Co. of Pittsburgh Independent Director Liability Package ("IDL")

www.aig.com/directorsofficers

Features:

- Makes non-rescindable limits available exclusively for independent directors to pay defense costs, settlements and judgments in D&O claims when the primary and excess D&O policies do not advance payments and are either actually rescinded or threatened to be rescinded;

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

- Coverage despite financial reporting restatement;
- Funding when a nonseverable warranty is breached;
- Protection if the corporation declares bankruptcy;
- If enhanced to include “difference in conditions” coverage via an endorsement, IDL Premier will respond as follows:
 - Financial inability by the underlying carrier to indemnify insured persons – policy drops down to provide nonindemnifiable loss coverage in the event the underlying insurer is financially unable to indemnify the insured persons;
 - Application of an exclusion in the underlying D&O program – policy provides primary nonindemnifiable loss coverage to the insured persons who have been denied coverage due to the application of inconsistent terms and conditions of the underlying policy;
 - Policy will drop down and fill in the retention amount, which the underlying carrier wrongfully applied.

PUBLICATIONS BY DAVID A. GAUNTLETT

David A. Gauntlett is the author of *Insurance Coverage of Intellectual Property Assets* published by Aspen Law & Business. The book and the supplements are available for \$160.00 plus 8.5% tax; shipping and handling are free when full payment is enclosed with the order. Call 1-800-638-8437.

UPCOMING SEMINARS/ARTICLES ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

International Business Law Service’s Strategic Global Summit for E-Commerce – Sept. 18 - 19, 2003 – San Juan Capistrano, CA

Licensing Executives Society’s 39th Annual Meeting – Sept. 21 - 25, 2003 – Manchester Grand Hyatt, San Diego, CA

Mealeys - Fundamentals of Insurance Coverage Law Conference – Oct. 20, 2003 – The Westin Chicago River North, Chicago, IL

David A. Gauntlett is on the Editorial Board of IRMI’s CGL Reporter and Summarizes Insurance Coverage Case Law

David A. Gauntlett Also Authors a Monthly Article on Insurance Coverage Issues for the Licensing Journal

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