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## **D&O INSURANCE – ADVANCED ISSUES**

**12:15 PM**

Gordon (Chip) Davenport III, Foley & Lardner LLP

Dan Fortin, CNA Financial Corporation

Ethan Lenz, Foley & Lardner LLP

Mike Rice, Aon Corporation

Steve Shappell, Aon Corporation



**GORDON DAVENPORT III**  
PARTNER  
FOLEY & LARDNER LLP

Gordon Davenport III, a partner with Foley & Lardner LLP, is an experienced litigator who has counseled and represented clients in complex commercial litigation and insurance matters, including product liability cases, distribution litigation, national class actions, insurance coverage disputes, and insurance distribution and sales practices matters. Mr. Davenport is also a leader in the field of Directors and Officers Insurance. He is a member of the firm's Insurance Dispute Resolution and Distribution & Franchise Practices as well as the Insurance Industry Team.

Mr. Davenport is admitted to practice before the U.S. Supreme Court, the U.S. Court of Appeals, Seventh Circuit, and the Eastern and Western Districts of Wisconsin. He is a member of the Dane County Bar Association, State Bar of Wisconsin and American Bar Association (Litigation and Tort and Insurance Practice Sections).

Mr. Davenport is a graduate of the University of Wisconsin, where he received his business administration degree in 1980 and his J.D. degree (*cum laude*) in 1983. He was a member of the *University of Wisconsin Law Review* and was elected to the Order of the Coif.



**DAN FORTIN**  
SENIOR VICE-PRESIDENT  
CNA FINANCIAL CORPORATION

Dan has been with CNA for 15 years and is responsible for leading a number of underwriting areas within CNA's Specialty Lines segment that provide management liability, professional liability and fidelity insurance products to large commercial firms, financial firms and large law firms. At CNA, he is charged with developing and executing underwriting strategies, establishing broker and insured relations, and structuring reinsurance treaties. In addition to overseeing underwriting operations he is involved in actuarial and claim functions. Dan started his career at CNA in 1991 as an underwriter focusing directors and officers liability insurance provided to publicly traded commercial firms. He also serves as a director on the board of CNA's European insurance company. Dan received his undergraduate degree from Villanova University and his graduate degree from Northwestern University's Kellogg Business School.



**ETHAN LENZ**  
PARTNER  
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Ethan D. Lenz is a partner with Foley & Lardner LLP. He is a member of the Insurance and Health Care Industry Teams, as well as the Insurance Dispute Resolution Practice. Mr. Lenz's practice focuses on providing risk management and insurance coverage-related advice to many of the firm's commercial clients, including advice relative to the negotiation and structure of directors and officers liability insurance programs, and a wide variety of other commercial/professional insurance programs. He also provides counseling on insurance regulatory and insurance producer licensing matters for the firm's insurance industry clients.

Mr. Lenz is a graduate of the University of Minnesota (J.D., *magna cum laude*, 1996) and the University of Wisconsin - Madison (B.B.A., *with distinction*, 1991), majoring in risk management and insurance. He has also earned the Chartered Property Casualty Underwriter (CPCU) designation from the American Institute for CPCU. He was a member of the legal staff of Northwestern Mutual Life Insurance Company for a brief period, prior to returning to practice at Foley & Lardner.

Mr. Lenz is admitted to practice in Wisconsin and in the U.S. District Court, Western District of Wisconsin. He is a member of the State Bar of Wisconsin, the American Bar Association (Business Law and Administrative Law & Regulatory Practice sections) and the Milwaukee Bar Association.

Mr. Lenz is the co-author of "Workers' Comp and Employer Liability Carriers in Jeopardy with Sexual Harassment Charges," published in *Insurance Specialist*, Second Quarter 1998. He is also a regular speaker on insurance-related topics, including current issues affecting directors and officers' liability insurance, other commercial insurance products and the Terrorism Risk Insurance Act.

Mr. Lenz was named to the 2006 list of Wisconsin Super Lawyers – Rising Stars by *Law & Politics Media, Inc.* for his insurance coverage work.



**MICHAEL D. RICE II**  
CEO  
AON FINANCIAL SERVICES  
GROUP

Mike currently serves as Chairman for the Aon Risk Services Chicago and Chief Executive Officer of Aon Financial Service Group (FSG). Aon FSG is a national practice group for executive liability coverages that places approximately \$3 billion in premium yearly. He is also a member of the Aon Risk Services US Executive Committee. His specialty is Executive Liability (D&O) Insurance for Fortune 500, Tech & Telecom and Initial Public Offerings.

Mike is the architect and original Managing Director of Aon Technology Group which specializes in the insurance needs of Technology & Telecommunication companies as well as an original founder of Aon's online insurance market submission process known as Aon Market Exchange (AMe).

Mike was selected as a double winner in the inaugural 2006 Risk and Insurance Magazine Power Broker Survey in Computer Hardware and Telecommunications. He received his Bachelor of Science - Finance from Boston College, 1989.



**STEVE SHAPPELL**  
MANAGING DIRECTOR  
AON FINANCIAL SERVICES  
GROUP

Steve has been with Aon for 8 years and is the Managing Director of Financial Services Group, Legal & Clams Practice, which provides legal support on Directors and Officers Liability, Fiduciary Liability, Errors and Omissions, Employment Practices, and other FSG matters. Steve assists clients and the Aon network with litigation, claims, coverage, risk assessment, risk management, and brokerage issues.

Steve has over 20 years of experience in the insurance industry, most of which involved litigation of complex insurance issues. He served as counsel in the CIGNA House Counsel operation. Prior to that, Steve was in private practice with a prominent Denver law firm, specializing in insurance-related matters.

Steve is a frequent lecturer at UCLA Graduate School of Business, University of Wisconsin School of Business, PLUS, NVCA, and RIMS. He received his education at University of Colorado-Boulder, University of Denver - Juris Doctor.



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# STAND-ALONE “SIDE A” WHAT IS IT (AND DO I NEED IT)?

## BACKGROUND

The typical D&O Insurance Program for a publicly traded company contains three types of coverage, or “insuring agreements,” in one policy. These coverages are often referred to as Side A, Side B and Side C (or Entity) coverage. In recent years, there has been a trend for companies to also purchase additional, stand-alone, Side A Coverage for their directors and officers.

Based on our experience, coverage provided under Side A is often misunderstood, or at least not clearly understood, by directors and officers. Therefore, we hope to provide some additional insight by way of this brief overview, along with several questions that can be used as a starting point to determine if additional Side A Coverage is appropriate for your circumstances. These questions, and others, will also be discussed in greater detail in the “Lunch ‘N Learn” session on “D&O Insurance – Advanced Issues” at the National Directors Institute.

## STRUCTURE OF A TYPICAL D&O INSURANCE PROGRAM

As noted, the typical D&O Insurance Program contains three coverages (including Side A) under one policy. In short, these coverages are:

1. “Side A”– Coverage for both defense expenses and payments of settlements/judgments that arise from claims brought against directors and officers, when those costs cannot be indemnified by the company. Usually, no retention (deductible) applies to Side A coverage. Therefore, it affords protection against individual directors and officers having to use their own resources to pay the costs of any claims for which they are not indemnified by the company. In essence, Side A coverage provides the final layer of protection between an individual director’s or officer’s personal assets and the plaintiff(s) in a claim.
2. “Side B” Coverage – This is also often referred to as “company reimbursement” coverage. It reimburses the company for costs of claims when the company is permitted, or required, to indemnify individual directors and officers. Because the majority of claims against directors and officers are eligible for indemnification, Side B is the primary coverage under which payments are typically made under a D&O insurance policy.



3. “Side C”/Entity Coverage – This provides coverage for claims when the company itself is a defendant in the claim. For publicly-traded companies, it typically only provides coverage for securities-related claims. For example, if a securities-related lawsuit names both the company and individual directors/officers as separate defendants, Side C coverage will come into play for any defense costs and/or judgments or settlements that are attributable to the company’s separate alleged liability. On the other hand, if a policy does not include Side C coverage, any amounts allocated to the company’s defense or ultimate liability in that claim would not be covered by the policy.

### **TYPICAL CLAIMS SITUATIONS TRIGGERING SIDE A COVERAGE**

As discussed in the preceding section, “traditional” Side A Coverage is only triggered if the company cannot indemnify the directors and officers for a claim. Usually, this involves one of the following circumstances:

1. The claim is in the form of a derivative action, brought on behalf of the company, and state law prohibits the company from indemnifying defense costs or settlements/judgments arising from derivative actions.
2. The company is insolvent and, therefore, cannot indemnify the directors and officers.

In addition to these situations, a number of insurers offer stand-alone Side A policies, often referred to as “Side A DIC” or “Difference in Conditions” policies which profess to offer coverage in other situations, such as where the primary D&O insurers wrongfully refuse to provide coverage, where exclusions in the primary D&O Insurance Program preclude coverage or where the primary D&O Insurance Program has either been exhausted or rescinded. These types of policies vary widely with respect to the scope of coverage that they provide, and should be carefully reviewed by a specialist in D&O coverage to ensure that they offer the coverage they purport to offer.

### **HOW CAN I DETERMINE IF STAND-ALONE SIDE A IS APPROPRIATE?**

As is the case with all D&O insurance, one size never fits all. Therefore, while additional Side A coverage may be highly desirable in some situations, it may be less desirable in others. To help determine whether additional Side A coverage is appropriate in your situation, you can start by asking the following questions:

1. **How do the limits of my company’s primary (Side A, B and C) D&O Insurance Program compare to others in our peer group?**

A number of reputable organizations publish studies showing the limits of D&O insurance carried by publicly-traded companies. These are typically broken down by several





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different demographic factors, including industry, market cap and revenues. Your company's insurance broker should have this information readily available. This "benchmarking data" is a useful starting point, as it shows where your company's limits stand in comparison to other companies in your peer group. If your company's limits are significantly below those of other companies in your peer group, additional Side A limits (or additional Side A, B and C limits) may be appropriate.

**2. Does my company's primary D&O Insurance Program contain an "Order of Payments" provision?**

One of the traditional selling points of stand-alone Side A coverage is that it provides dedicated limits for the individual directors and officers. As discussed previously, most primary D&O Insurance Programs include Side A, B and C coverage in one policy. Therefore, directors and officers share the limits of the policy with the company. If the company's indemnification obligations, or its separate liability, deplete the limits of insurance under the Side B and C coverage, this can leave the individual directors and officers "bare."

Despite the preceding, the problem of being left bare by depletion of the policy's limits under Sides B and C can be significantly reduced if the primary D&O Insurance Program contains an appropriate "Order of Payments" provision. In general, such a provision will provide that in all claims situations, any payments due under Side A must be made before the company is reimbursed or otherwise receives any coverage under Sides B and C. Thus, the "Order of Payments" provision can largely have the effect of dedicating the primary D&O Insurance Program limits to the individual directors and officers, at least as they relate to any particular claim.

**3. Is the Side A coverage in my company's primary D&O Insurance Program fully non-rescindable and/or does the coverage have strong severability language for application misrepresentations?**

Another selling point of many stand-alone Side A insurance policies is that they are non-rescindable. That is, once they are written, the insurer cannot later look for misrepresentations in the application to void the coverage. This can be an important feature, as it avoids the situation where the coverage is seemingly in place, but "disappears" when a claim arises and the insurer discovers an alleged misrepresentation in the policy application. However, many insurers have recently begun to alleviate this potential problem in primary D&O insurance coverage by offering Side A, B and C policies that include non-rescindable Side A coverage.

In addition to the preceding, if your company's primary D&O Insurance Program includes a favorable "severability" provision relative to application misrepresentations, this can alleviate much of the potential for rescission of your individual coverage at the time of a claim. Such a provision should essentially provide that in the event the application contains any misrepresentations, the policy can only be rescinded as to those individual directors and officers who knew the misrepresentation existed in the application. In this



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regard, it should be noted that the provisions relative to application misrepresentations and severability vary widely among insurers, and seemingly small differences in language can lead to significantly different coverage consequences. Accordingly, these provisions should be carefully reviewed by a professional that is well-versed in D&O insurance coverage.

**4. Does state law allow my company to indemnify me for costs arising from derivative actions?**

Both the number of derivative actions, and the costs of resolving those actions, have risen in recent years. As such, it is important to know whether state law in your company's state of domicile allows the company to indemnify individual directors and officers for both defense costs and settlements/judgments related to derivative actions. If state law does not allow such indemnification, or places burdensome restrictions on such indemnification, it increases the likelihood that you may sometime be faced with a situation where you will be seeking Side A coverage for costs that are not indemnified by the company. In turn, this increases the desirability of additional Side A coverage.

**5. Does my company have a strong and stable balance sheet?**

Because insolvency is one of the primary instances where Side A coverage might be triggered, it is important to understand the current strength, and the likely ongoing stability, of the company's balance sheet when evaluating the need for additional stand-alone Side A coverage. Of course it is always difficult to predict what the balance sheet will look like at the time a claim is actually filed, but the more volatile the balance sheet, typically the more the potential need for additional Side A coverage might come into play.

**CONCLUSION**

The preceding questions and their potential answers are not meant to be an exhaustive list of all considerations that should go into the decision-making process regarding stand-alone Side A insurance coverage. However, they provide a good starting point for evaluating whether or not your company should further explore the purchase of stand-alone Side A coverage. Other considerations that should be kept in mind include the fact that stand-alone Side A coverage typically commands premiums in the range of 70%-80% of the premium for the same limits of Side A, B and C coverage, despite the more limited circumstances in which it typically responds. Additionally, if the decision is made to purchase stand-alone Side A coverage, it should always be kept in mind that these policies vary widely in the coverage that they provide. The policies should be carefully reviewed and heavily negotiated to ensure that they provide the broadest protection available to best protect the personal assets of individual directors and officers.

# THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

## Board IT Priorities in Addressing Technology

		Information and Technology's Strategic Value			
		LOW			HIGH
		<b>Type 1: IT supports the business</b>	<b>Type 2: IT supports competitive advantage</b>	<b>Type 3: IT provides competitive advantage</b>	<b>Type 4: IT is the business</b>
<b>Priorities</b>		<ul style="list-style-type: none"> <li>Use technology to help business run more smoothly</li> <li>Ensure reliable support and ease of day-to-day operations at minimal cost</li> </ul>	<ul style="list-style-type: none"> <li>Use technology to improve or support some key areas of the business</li> <li>Determine which areas would benefit from technology and improve/support those areas at minimal cost</li> </ul>	<ul style="list-style-type: none"> <li>Use technology to improve or support many key areas of the business</li> <li>Select and use technology with goal of competing more effectively</li> <li>Manage IT-related investments and risks</li> </ul>	<ul style="list-style-type: none"> <li>Lead industry through best use of technology</li> <li>Constantly seek to improve technology improve or maintain strategic position</li> <li>Manage large IT investments and risks</li> </ul>
<b>Address IT by</b>		<ul style="list-style-type: none"> <li>Ad hoc or regular audit review</li> </ul>	<ul style="list-style-type: none"> <li>Regular audit review</li> <li>May be reviewed as part of business function</li> </ul>	<ul style="list-style-type: none"> <li>Frequent audit review, or agenda item when needed for project implementation</li> </ul>	<ul style="list-style-type: none"> <li>Regular agenda item</li> <li>IT Committee</li> </ul>
		<b>IT as commodity</b>		<b>IT as strategic differentiator</b>	

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## Board IT Priorities

Board's oversight of IT will change based on

- Competing priorities
- The current "Strategic Value" of IT to the company
- Legal and regulatory requirements associated with IT issues
- Technology literacy/comfort of board/committees
- Best vehicle for board and corporate culture
- Board may address IT as part of a larger and more business-oriented objective, as a separate item, or, most commonly, as a hybrid

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## "Triggers" for placing IT on the board's agenda

- Traditional triggers
  - A crisis
    - natural disaster takes out a data center
    - Y2K
    - competitive crisis)
  - An event
    - Outsourcing
    - core system replacement
- Regulatory Triggers
  - Data protection
  - Financial controls
- Less obvious triggers
  - Focused assessment of IT component in key business initiatives
  - Monitoring/questioning of general impact of IT on operations/competitiveness

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## “Triggers” for placing IT on the board’s agenda

- Recommendations
  - Understand that the role of board and its committees will change based on the companies current needs- understand triggers impacting your company
  - Improving technology literacy on board /committees – board orientation
  - Create processes that enable IT to be addressed in context and more holistically by the board, rather than as a series of one off events

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## Bringing it Together – What you can do Differently Next Quarter

- Determining the Board’s role
  - Assess both the state of the business and the role of IT in the business
  - No one size fits all
  - Changing emphasis on Board’s role between monitoring and advising
- Consider immediate change with regard to key events
  - Outsourcing
  - ERP
- Plan the Board’s role
  - Agree on an approach for this year
  - how often on the agenda
  - what topics
  - who leads from management
  - how IT integrates with the overall agenda

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Questions

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