Avoiding Unintended Gaps in Directors & Officers and Professional Indemnity Insurance

The following hypothetical claim scenario illustrates a potential risk faced by many companies: A consumer services company maintains a comprehensive insurance program that includes both directors and officers (D&O) liability insurance and professional, or errors and omissions (E&O), liability insurance. Six months after renewing its policies, the company is served with a costly class action lawsuit. The plaintiffs allege they suffered monetary loss when they purchased the company's products based upon the company's allegedly misleading product descriptions. The plaintiffs seek damages, injunctive relief and attorneys' fees for the company's alleged violation of state unfair business practices and consumer protection statutes.

Because the suit alleges wrongful acts potentially covered under both lines of insurance, the company tenders it to both the D&O and the E&O insurers. But the D&O insurer contends the claim is barred by the policy's exclusion for undefined "professional services," while the E&O insurer contends that the alleged wrongful acts do not constitute "professional services" as defined narrowly by the insuring agreement of the E&O policy.

The company thus faces a difficult class action suit and disputes with two insurers over defense and indemnification for the claim. However, this potential coverage gap could have been avoided by taking certain precautionary steps during policy negotiation and placement to ensure the policies interacted as intended.

Background

Briefly, D&O insurance protects directors and officers against a wide range of claims alleging wrongful acts in carrying out their duties, and reimburses the insured company for its costs of indemnifying the individuals against such claims. Further, D&O insurance typically protects an insured public company against certain securities liability claims

asserted directly against the company, and protects an insured private company against an even wider universe of claims. With limited exceptions, D&O policies are not intended to insure professional liability exposures, and many (particularly those issued to public companies) exclude claims arising out of the rendering of, or failure to render, professional services.

Insurers believe generally that professional liability exposure should be underwritten and covered by a separate E&O policy. E&O insurance protects companies or individuals that offer professional services against liabilities for alleged errors or omissions in performing those services. Policy terms can vary, including central features such as the insuring agreement and the "professional services" definition. Typically, E&O insurance does not apply to the management and oversight activities of officers and directors, as their roles on behalf of the organization are not considered professional services to third parties.

D&O policy exclusions often do not define the term "professional services," while E&O policies do so in virtually every instance, typically including a list of insured services that may be tailored to the insured's specific business, or at least its industry segment. This lack of a precise "fit" between the policies can generate uncertainty and disputes: Does a gap exist where contrary to the insured's expectations the claim is not covered by either the D&O or the E&O policy? Or do the policy forms overlap such that coverage arguably exists under both policies? Overlapping coverage for a single claim, while theoretically positive for the insured (and certainly so when the loss exceeds the limit of either policy), can give rise to time-consuming and costly allocation disputes that undercut the benefit of "double" insurance.

Steps to Consider During Policy Negotiation and Placement

Although it is impossible to foresee every claim, companies can take steps during policy negotiation and placement to eliminate unintended gaps and overlaps between their D&O and E&O policies.

If possible, the wording of each policy should be reviewed together. In particular, the insured should seek an E&O policy definition of "professional services" that is broad enough to include every service the company performs for others. At the same time, the insured should request a clearly defined "professional services" exclusion in the D&O policy (if one is required by the insurer) that bars only those matters encompassed by the E&O policy's insuring agreement. Where "professional services" in the D&O policy exclusion either is undefined or defined more broadly than in the E&O policy's insuring agreement, a claim potentially could fall into a gap between the two policies.

Other language in the relevant D&O exclusion and E&O insuring agreement should be

scrutinized to ensure it fulfills the parties' intent. For example, if the provision employs phrases such as "arising out of" or "relating to" the insured's rendering or failure to render professional services, a court is likely to interpret this provision broadly. Different language may be interpreted more restrictively, such as "caused by," "due to" or, most simply, "for." An insured purchasing E&O insurance would favor the broader description, while a prospective purchaser of D&O insurance would benefit from the simpler, more restrictive preamble.

Professional services exclusions can be limited further to fulfill the parties' intent. Commonly available terms include clarifications that only professional services "performed for others for a fee" are excluded, and the insured's "supervision" of professionals is not itself an excluded professional service. Of course, the desired language may not always be available from a particular market, but insureds should determine their alternatives.

Beyond terms relating expressly to "professional services," insureds should review the policies' "other insurance" provisions to determine how they will interact if there is overlapping coverage. If the parties intend one policy to have priority, special policy language likely must be added by endorsement. Absent this addition, the "other insurance" provisions may be "mutually repugnant," meaning each states the policy is excess over any other applicable insurance. How these conflicting terms are resolved is a matter of state law, which should be understood before the policy terms are finalized.

Purchasing D&O and E&O primary policies from the same insurer may reduce the risk of being caught between two seemingly contradictory coverage positions. The practical reality is when the same insurer is writing both policies, negotiating language that ensures a good fit between the policies will be easier and the insured will be less likely to face an actual or purported coverage gap. It will still be necessary to identify the responsive policy in the event of a claim, but that function also should be easier when the same primary insurer is on both sides of the divide.

In summary, there can be coverage gaps between D&O and E&O policies, or overlap between these two coverage lines. Consult your insurance advisors during policy negotiation and placement to ensure these coverages interact as intended.