

Special Bulletin

Friday, December 5, 2008



NEW YORK INSURANCE DEPARTMENT, OFFICE OF GENERAL COUNSEL, ISSUES CONTROVERSIAL OPINION CONCLUDING THAT INSUREDS CANNOT BEAR DUTY TO DEFEND UNDER A D&O INSURANCE POLICY

by Carrie E. Cope

Earlier this year, we advised a number of our clients that the New York Insurance Department (“the Department”) was considering mandating that directors’ and officers’ liability policies issued in the admitted market contain a duty to defend the insureds, whether or not such policies were issued to public companies. The issue arose in the context of a D&O filing pending before the Department (which was one of many filings raising this issue).

On October 16, 2008, the Department issued OCG Opinion No. 08-10-07 (“the Opinion”), which set forth this mandate. In our opinion, the Department’s decision is not only incorrect, but fails to take the practicalities of doing business in the public company D&O arena, where the stakes are often high and the players sophisticated, into consideration. As anyone with familiarity with New York insurance laws and regulations knows, they can sometimes present an intricate roadmap of issues and connections that can be difficult to navigate. However, the reasoning in the Opinion is only very loosely based on New York insurance laws and regulations. Moreover, the Opinion conflicts with decisions by New York courts that have interpreted D&O policies in which the insureds had the right and duty to defend themselves. Although the Department disputes that it has had a longstanding position of permitting insureds to defend themselves under public company D&O policies, the fact is that the Department and other regulators across the country have been approving D&O insurance policies for use in the admitted market, in

which the insureds have the duty to defend themselves, for a number of years.

Finally, and perhaps most importantly, the Opinion fails to address the needs and desires of the insureds that it seeks to protect. D&O policies are purchased by corporations to respond to the risks inherent in their business activities. They may also be purchased directly by directors who sit on corporate boards. The scope of coverage is often heavily negotiated and corporations commonly employ risk managers who are experienced in such negotiations. However, the Department’s Opinion states that the proposed filing runs afoul of Regulation 107 by limiting the availability of coverage for legal defense costs and notes that the insurer is transferring to the insureds its “duty to absorb the administrative costs of litigation, such as the cost of managing, controlling and otherwise overseeing the litigation.” This premise fails to recognize that the

ability to oversee the litigation is exactly what the typical insured purchasing a public company D&O policy wants. The Department further criticizes the D&O policy at issue, as it does not pay the compensation or other costs of the insured’s in-house counsel involved in the process. The Department fails to recognize that even if the insureds have the duty to defend themselves, D&O policies do not, and are not intended to, pay the salary of in-house counsel monitoring the litigation, but rather solely the costs incurred by outside counsel retained to defend the insureds.

The Opinion, if not further modified, may well have a chilling effect upon the D&O insurance industry in New York and unduly cause applicants to seek means to obtain the coverage they need and want outside the State of New York. We welcome comments from our clients and colleagues on this very important issue.

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