

# Avoiding Common Mistakes When Purchasing D&O Policies

By Adam J. Epstein

Many companies that are small-cap or on the cusp of an initial public offering (IPO) struggle with purchasing director and officer (D&O) liability insurance. Unlike larger public companies where management, the board, and corporate governance professionals assist in expertly analyzing D&O policies, skeletal staffs and less experienced officers and directors can make assessing these policies daunting for smaller companies.

To discuss how small-cap company directors can cope with these issues, I recently spoke with Dan Berry, senior vice president, Private Equity and Venture Capital Group, at Woodruff Sawyer & Co.; Michael J. Biles, partner at King & Spalding; Boris Feldman, partner at Wilson Sonsini Goodrich & Rosati; Jeremy M. King, partner at Olshan; and Clark Morton, senior vice president, Woodruff Sawyer & Co. Here are eight key takeaways from my conversations with them.

**1. Brokers matter.** “D&O insurance is one of the most technical and tactical placements in insurance brokerage,” Berry said. “The worst thing a company can do is use a general practitioner for this line of coverage. If your broker is not in the market working deals like this every day, they will underperform.”

**2. Premiums.** Pre-IPO and small-cap companies often have

resource constraints. But Feldman says that D&O insurance premiums are not the place to cut corners and that smaller companies shouldn’t automatically go with the lowest premium. “D&O is definitely not a commodity,” he said.

**3. Limits.** No conversation about policy premiums can take place without an analysis of appropriate policy limits. Biles advises that if D&O limits are too small, then officers and directors risk personal exposure. But too much isn’t good either. “If the D&O limits are too high, then the company not only wastes money on unnecessary premiums, but also can prolong litigation as plaintiffs’ lawyers hold out for a larger portion of the policy proceeds,” he explained.

**4. Pre-IPO.** Some private companies contemplating an IPO try to save money by not obtaining D&O coverage until they are publicly traded. Feldman encourages companies to secure D&O policies while they are still privately held so that they can negotiate continuity of their policy and cover the pre-IPO period.

**5. Side A is critical.** “Side A policies provide officers and directors with broader coverage with fewer exclusions than Side C and Side B policies, and it is more difficult to rescind Side A policies once the premium is paid,” Biles said.

**6. In-house counsel.** D&O policies typically cover actions that

are taken as an officer or as a director. But even where an in-house counsel is an officer of the company, they might be excluded from coverage when they are principally acting as a “lawyer,” said Biles. According to Biles and King, the key is to make sure that the definition of the term “insured” explicitly includes them in the policy.

**7. Government investigations.** Government investigations of companies are either formal or informal. Many D&O policies only cover formal investigations, often subsequent to the receipt of a subpoena. Problems can arise when, for example, the Securities and Exchange Commission (SEC) informally requests documents or asks to interview corporate personnel without serving a subpoena. Informal SEC investigations can ultimately cost a company hundreds of thousands of dollars in unanticipated legal fees.

“This places the company in the awkward position of actually wanting the government to initiate a formal investigation to trigger coverage,” Biles said.

**8. Garbage in, garbage out.** Morton counsels his clients that you don’t get what you don’t ask for. “An off-the-shelf policy from an insurance company will lack some expansions of coverage, which can materially impact the extent to which the policy will respond to claims,” he observed.



Adam J. Epstein was an institutional investor who now advises pre-IPO and small-cap boards through his firm, Third Creek Advisors LLC. He is the author of *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies* (McGraw-Hill, 2012).