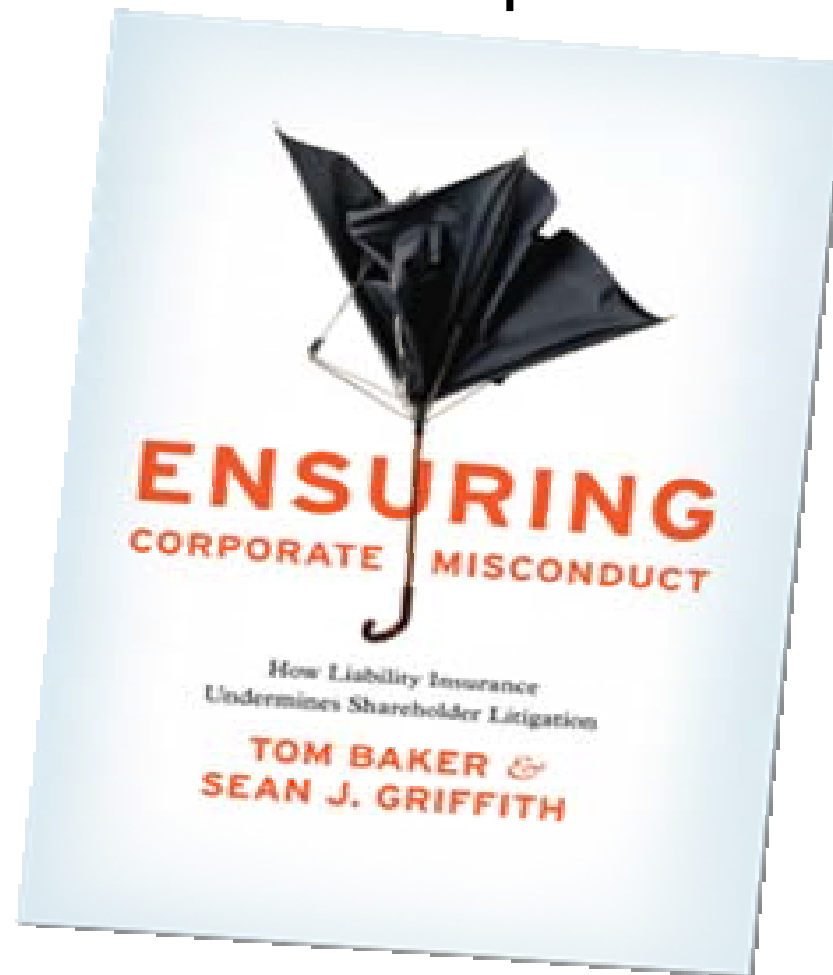


# D&O Insurance and the Ability of Shareholder Litigation to Deter

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## D&O Insurance and Corporate Governance



Deterrence is the *raison d'être* of shareholder litigation.

Insurance subverts deterrence and makes shareholder litigation look like waste.

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## Side A

“... the Insurer will pay on behalf of the Directors and Officers Losses which the Directors and Officers shall become legally obligated to pay ....”

- Insurer pays **individuals** for losses the corp cannot indemnify.

## Side B

“... the Insurer will pay on behalf of the Company Losses for which the Company has, to the extent permitted or required by law, indemnified the Directors and Officers ... as a result of a Claim ... against the Directors and Officers ....”

- Insurer pays **corp** for corp's obligations to individuals.

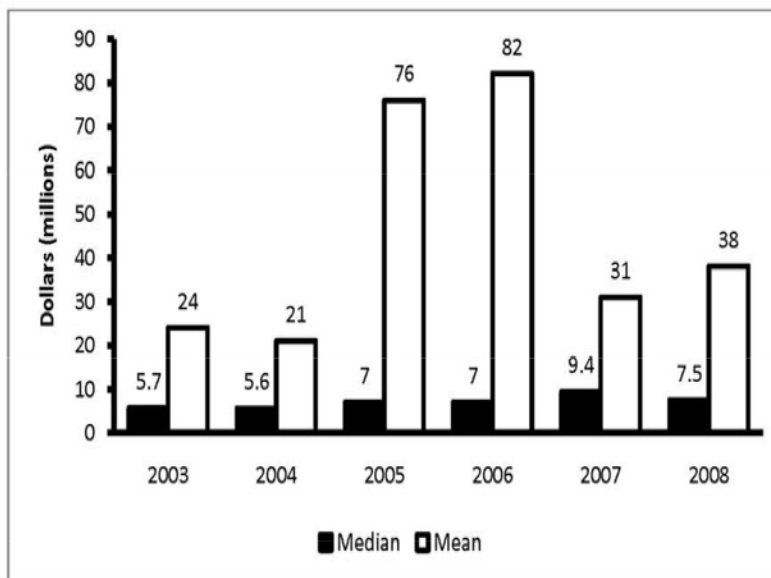
## Side C

“... the Insurer will pay on behalf of the Company Loss which the Company shall become legally obligated to pay as a result of a Securities Claim ... against the Company for a Wrongful Act ....”

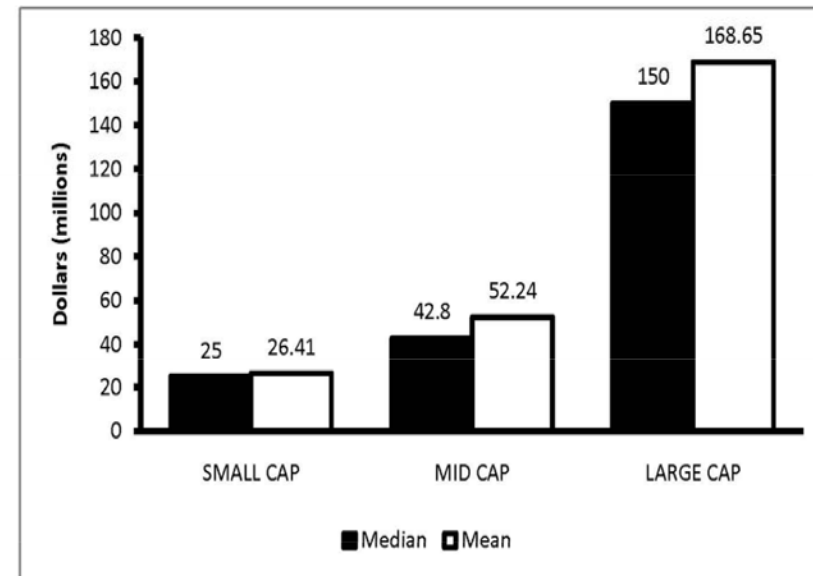
- Insurer pays **corp** for corp's own losses as a defendant.

## Shareholder Litigation Settlements and D&O Policies

Average Settlements (10b-5)



Average D&O Limits



Deterrence is the *raison d'être* of shareholder litigation.

Insurance subverts deterrence and makes shareholder litigation look like waste.

Unless the insurer-insured relationship introduces some constraint on the insured.

## Reintroducing Deterrence

1. Through pricing
- ~~2. Through monitoring~~
3. Through selective payment of claims

## Pricing and Deterrence

- Insurers do seek to price to risk.
- Financial factors:
  - Industry
  - Maturity
  - Market capitalization
  - Volatility
- Governance:
  - Not (primarily) charter provisions
  - “Culture” and “Character”



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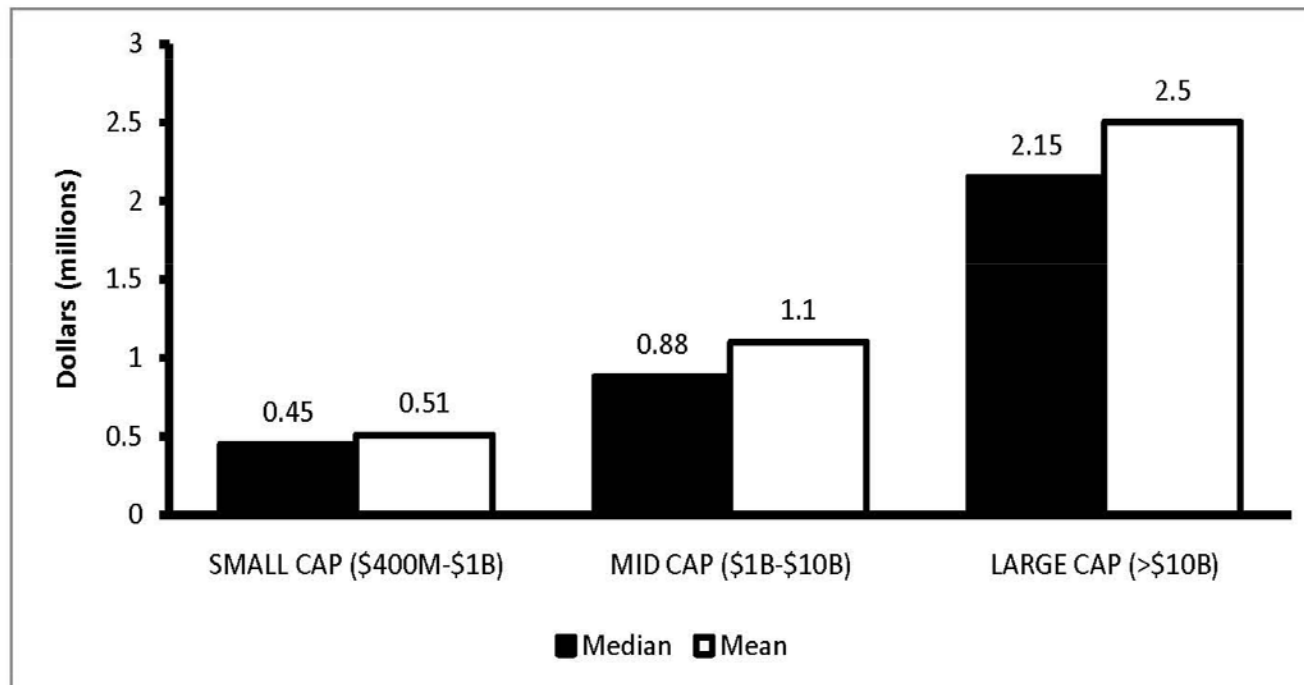


*When Mr. Wirthmore began wearing a crown at board meetings, no one said a word about it...but they did vote unanimously to up their D&O policy limits.*

c.06CharlesFincher11.22 Scribble-in-Law at LawComix.com

## But does pricing = deterrence?

### D&O Premiums



## Selective Settlement and Deterrence

- Defendant controls the defense (unlike other forms of insurance), but insurer has veto power over settlement.
- BUT:
  - Effect of settlement demand within limits ...
    - Risk of “bad faith” failure to settle claim, making insurer liable beyond limits
    - Plaintiff and Defense Counsel collusion
  - Absence of guidance: settlements all the way down

## Coverage Defenses and Deterrence

- Exclusions (especially the “Fraud” exclusion)
  - Policy language: “Actual” fraud determined by “adjudication”
  - Strategic pleading: Recklessness
- Rescission (for “Fraud in the Application”)
  - Weakness of rescission threat given market constraint
  - But trade-offs to make insured pay into within limits settlements:  
"cashing-in coverage defenses"

# The Disclosure Solution

- Mandatory disclosure of:
  - Premiums, limits, structure, and other policy details
  - Amount and Structure of Coverage and Structure of Settlements
    - Who funds settlement and defense costs
    - In what proportion