

Navigating D&O Insurance Renewals under Scrutiny for Stock Option Backdating

By John A. Doernberg

Recent news coverage has focused attention on how some publicly traded companies may have backdated stock option grants. Shareholder class action claims have already been made against some of these companies, alleging that their SEC filings and other public disclosures were materially misleading and that their directors and officers breached their fiduciary duties in backdating stock options. Many public companies and their compensation committees are actively reviewing the situation, and some have commenced internal audits or third party assessments. The issue is not simple to review. Many companies are assessing whether options may have been backdated, whether or not the practice was permissible under the policy governing option grants at the time, and whether they correctly accounted for the grants. At this point the legal standards governing potential liability and the associated regulatory consequences for companies are not predictable. In some cases, however, D&O insurers have reacted by seeking higher premiums and retentions, as well as coverage terms and conditions that will help them limit and manage their exposure to potential claims.

NASDAQ Insurance Agency – Carpenter Moore serves as the D&O insurance broker for hundreds of public companies, including several among those identified in the press as being under scrutiny. We believe that D&O insurers' concerns about their exposure to option-grant claims will have a significant impact on the current D&O insurance cycle for all public companies — whether or not they have been accused of backdating stock options. NASDAQ Insurance Agency – Carpenter Moore has been working actively and in depth with our clients and their counsel to analyze the insurance coverage issues involved and develop effective strategies to help our clients in their coming D&O insurance renewals. Our mutual goals are to address the concerns of D&O underwriters about option granting practices and to negotiate the best possible D&O coverage for our clients.

Special Attention to Renewals Required

As a result of the current focus on stock option granting practices, the D&O underwriting process will be much more complex for many companies during the current renewal cycle. Underwriters have already been asking many hard and specific questions relating to stock option practices, and most companies are not yet in a position to answer these questions definitively. Insured companies should expect to devote considerable effort and focused attention to their renewals. Some of our clients have already created presentations for underwriters discussing the terms of their stock option plans, their stock option granting practices, and the trading price of their shares at the time of grant and at other times throughout the fiscal year.

Insurers may Seek Broad Exclusions in Renewals

Some insurers will seek to impose broad exclusions specifically barring coverage for claims relating to the backdating of stock options or they may try to impose or negotiate wording that would make it more likely that one or more of the standard D&O policy exclusions will be triggered in the event of a claim. Small differences in policy wording can have an enormous impact on the availability and extent of coverage in option-grant claims and in many other types of claims. In responding to potential coverage restrictions, companies and their advisors must understand the potential scope of the restrictions being negotiated. Insured companies can expect insurers to focus most intently on the following provisions and issues:

- Fraud exclusion
- Illegal Remuneration exclusion
- The definition of "Claim"
- Notice of Claim and "circumstance" provisions
- Personal Profit exclusion
- Insured versus Insured exclusion
- The definition of "Loss"
- Provisions governing rescission

Renewals may Require Difficult Decisions

Companies in difficult renewals may need to consider, among other things, whether they should give their incumbent insurers “notice of circumstances” in an effort to preserve coverage for option-related claims if additional restrictions are imposed at renewal or if coverage is moved to new carriers. Some companies may also be forced to consider whether they should exercise the expensive “discovery option” contained in virtually every D&O policy. These are among the most difficult decisions that companies can be called upon to make in the D&O insurance arena.

Be Prepared for your Renewal

Insured companies and their advisors should be prepared for an in-depth and sustained effort in the renewal process in order to obtain the best possible coverage for their D&O insurance programs. Companies need to make clear-eyed assessments of their preparedness for the D&O insurance renewal process, and of their brokers’ ability to assist them effectively.

Questions to ask in evaluating brokers’ preparedness and expertise include:

- How well do the brokers understand the unfolding option grant issues? Do they have experience representing other companies who have been identified as “high” or “moderate” risk?
- Are they prepared to advise the insured about how to make a strategic presentation to D&O underwriters in the insurance renewal process?
- Have they identified policy language that may affect coverage for claims relating to option-grant practices?
- If a claim is made, do they have dedicated claims resources that will actively work with insurers’ claims handlers to provide for the prompt advancement of defense costs and to combat any efforts by the insurers to deny coverage based on weak allegations or evidence?

If you believe there is room for improvement in the expertise and sustained high-level attention that your broker will devote to dealing with these critical issues, NASDAQ Insurance Agency – Carpenter Moore can help put you in the best possible position for your D&O insurance renewal. Please contact Susan Miner, President of NASDAQ Insurance Agency – Carpenter Moore, at 415.243.2305 to arrange for a brief telephone call or meeting.

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This alert is not intended as legal advice and should not be relied upon as such. John Doernberg is Senior Managing Director of NASDAQ Insurance Agency – Carpenter Moore.