Are You Covered?

Insurance Recovery Group

Insurance Recovery

INSURANCE COVERAGE FOR STOCK-OPTION BACKDATING CLAIMS

Corporate America faces a flurry of shareholder lawsuits, internal investigations, and federal probes into the practice of back-dating stock options. Back-dating stock options is not necessarily illegal or wrong. The questions revolve mainly around the degree to which the practice was (or should have been) disclosed to shareholders and how companies accounted for the back-dated options.

Companies facing back-dating investigations or lawsuits should do two things quickly: 1) examine their Directors & Officers ("D&O") policies; and 2) provide notice of claims or potential claims to their D&O insurers. Depending on the terms of its policy, D&O insurer may be obligated to cover the legal fees associated with back-dating investigations, lawsuits, and even criminal probes. To maximize the amounts the insurer will pay, companies must know their rights, understand the applicable law, and be diligent and aggressive in pursuing their (and their officers' and directors') policy benefits.

In response to notices of claims or potential claims, insurers are likely either to issue a "reservation of rights" letter or deny coverage outright. Some insurers may even seek to rescind policies asserting misrepresentation in the application process. Whatever the insurer's response, it must be carefully analyzed and answered appropriately. Further, some companies and individual directors have purchased Independent Director Liability or Side-A excess policies that provide defense cost and other coverage when a company's primary D&O insurer either denies coverage or attempts to rescind the corporation's policy. These policies, too, should be examined and may well be triggered if the corporation's primary D&O insurer refuses to provide coverage.

Common defenses or exclusions D&O insurers are likely to raise in response to back-dating claims, in addition to misrepresentation or rescission, include:

- The illegal gains or profits exclusion
- The fraud exclusion
- No coverage for disgorgement of profits
- The amount owed is less than the full amount claim because amounts must be allocated between insured and uninsured parties, or between covered and uncovered claims

Utilizing individual policy language (which can differ widely from policy to policy), case law, and particular facts and circumstances, corporations and their officers and directors should have substantial arguments in response to each of these exclusions and defenses. Knowing your rights and advocacy are key.

Reed Smith's Insurance Recovery Group consists more than twenty professionals with extensive experience in helping Fortune 500 policyholders to reverse coverage denials or otherwise to maximize insurance recoveries for shareholder class action, derivative, and other types of claims under D&O and a host of other types of policies.

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