Outside Director Liability Coverage and Joint Venture Companies

Companies often ask their directors or officers to serve on the boards of other organizations. In the event of potential liability, questions may arise about what type of insurance protects directors or officers in those roles. To address this risk, companies are increasingly turning to outside directorship liability (ODL) insurance.

ODL coverage is generally an extension of coverage under a company's directors and officers (D&O) liability policy, providing insurance protection for directors and officers of a company who also serve on the boards of outside entities at the primary company's request.

ODL coverage often works on a "double excess basis"; it applies excess of the outside entity's indemnification to the director or officer and the outside entity's own D&O coverage. In some cases, the ODL coverage works on a "triple excess basis," which means that the company's ODL coverage applies excess of the outside entity's indemnification to the director or officer, the outside entity's own D&O program, and the primary company's own indemnification to the director or officer.

ODL COVERAGE CONSIDERATIONS

ODL coverage issues often arise in connection with a joint venture (JV), a popular corporate structure in which two or more parties form a combined venture for a specific purpose, but maintain their original identities. Organizations may form JVs to enter new markets or develop new products, among other reasons.

Individual companies involved in JVs will likely maintain their own D&O policies with ODL coverage, but JVs may purchase additional coverage for the combined entity. This raises several issues, including:

- **Who qualifies as an insured person?** Frequently, the partner companies in a JV rely on their individual companies' ODL coverage to protect their respective employees on the JV's board. However, an often-overlooked consideration is that ODL coverage is generally only for executives specifically instructed by a company to sit on a JV's board. It does not follow other employees seconded to the JV — even, in some cases, those in executive or managerial positions. These employees may not be covered if they do not qualify as "insured persons" as defined by their employers' D&O policies.

- **Is the JV considered a subsidiary of a partner company?** If one partner has clear management control of the JV, the JV will often be deemed a subsidiary by that company's D&O insurer. This can be important if the JV is of material size, engaged in a high-risk industry, or operating in a foreign territory with an intensive or unstable regulatory regime; if the JV is deemed a subsidiary, it will share the full D&O policy limits, which can not only be dilutive but also negatively impact the company's risk profile.

- **What are the effects if the outside entity is insolvent or lacks appropriate insurance?** A common misconception is that ODL is a "throw-in" coverage, meaning that it is never triggered and does not affect the company's D&O insurance limits. This is not the case if the outside entity becomes insolvent or maintains insufficient D&O limits or if the outside entity's coverage does not respond (for any reason) to a specific claim. These circumstances can contribute to disastrous outcomes and underscore the importance of ensuring that each partner company has appropriate D&O insurance and limits.

- **In what capacity is the director or officer sued?** For ODL coverage to apply, the claim against the insured individual must be made in his or her professional capacity as a board member of the outside entity. If the claim alleges a wrongful act outside the individual's board or official company capacity, a coverage clash may occur, which can delay reimbursement or advancement of defense costs. Potential coverage issues can be avoided if both the JV and the company purchase D&O insurance from the same insurer. If the D&O insurer of the JV differs from that of the company, an "other insurance" clause, which is generally included in a D&O policy, may come into play. An "other insurance" clause sets forth the procedure by which loss is to be apportioned among insurers when more than one insurance policy provides coverage for the same loss.

- **How do non-admitted and admitted coverages apply?** If an ODL claim is brought in an overseas territory where indemnification and advancement of defense costs are prohibited, and the JV does not maintain any locally admitted D&O insurance, the company's D&O insurance would generally be triggered where the master policy is written. The company's master policy might pay "at the center" —

meaning that it might pay into the country where the D&O policy is written or possibly where the employer company is based — if non-admitted insurance is permitted. However, the decision to pay would be up to the insurer. This scenario could leave a JV board director living and working in that overseas territory without local coverage where the claim occurred.

MANAGING THE RISKS

To ensure that your company's D&O insurance program is appropriate for its purpose when it comes to the ODL coverage extension, consider the following steps:

- Review all JV/outside entity appointments and the JV's D&O insurance to ensure that its policy terms, coverage grant, and limits of liability are acceptable to you.
- Declare any appointments on a JV's board to your D&O insurer(s). Note that outside entity appointments to boards of publicly listed US companies and financial institutions often require specific approval from your D&O insurer.
- Scenario-test your company's D&O insurance program and how it works with the JV's D&O insurance. This can help you understand how each might respond in the face of a claim.

A firm grasp of ODL coverage can help mitigate the effects of potential D&O litigation. And an understanding of overall corporate and subsidiary exposures can help ensure that your company's D&O program limits are not inadvertently exposed to a claim that was not anticipated to be covered under its program.

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CAROLE LYNN (CL) PROFERES
US FINPRO Product and Industry Leader
+1 215 246 1105
carolelynn.l.proferes@marsh.com

SARAH D. KATZ DOWNEY
US FINPRO D&O Product Leader
+1 212 345 3122
sarah.d.downey@marsh.com

ROBERT G. BARNES
UK FINPRO Client Executive
+44 0 207 357 2158
robert.barnes@marsh.com

THOMAS P. SWIGERT
Partner, Dorsey & Whitney LLP
+1 612 492 5677
swigert.tom@dorsey.com