# Directors and Officers Securities Litigation Loss Prevention

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Note: The views, information and content expressed herein are those of the author and do not necessarily represent the views of Chubb.

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Introduction

Many companies frequently request their directors, officers, and employees to serve other organizations in various capacities (an “Outside Position”). These requests by a company can arise in numerous situations, including the following:

- The company wishes to support a charitable organization by placing a representative on the charity’s board of trustees;
- The company has a significant investment in another company and wishes to actively oversee the affairs of that portfolio company by having a representative serve on the portfolio company’s board of directors;
- The company is a member of a trade association and wishes to be proactively involved in the association’s activities by placing a representative on the association’s working committees;
- A parent company wishes to actively manage or oversee a subsidiary company by designating a representative to serve as either a director or officer of the subsidiary;
- In order to encourage good stewardship and develop leadership skills, the company encourages its employees to be active volunteers and leaders in community organizations.

Although requesting its directors, officers, and employees to serve in these types of Outside Positions can be beneficial to both the company and the individual, this practice can create potentially significant liability exposures for both the individuals serving in the Outside Position and the company that requests the individual’s service in the Outside Position. These exposures are some of the most commonly overlooked personal and entity exposures within a company. This booklet summarizes
many of the unique issues arising out of Outside Position service and identifies numerous indemnification, insurance, and loss prevention strategies to help address those issues.

Unique Liability Issues

Service in an Outside Position is troublesome not only because of the numerous liability exposures faced by any director or officer, but also because of several liability theories uniquely applicable to Outside Position claims, many of which are summarized below. In addition, plaintiffs realize that persons who serve in Outside Positions can be lucrative litigation targets since they may have access to indemnification and insurance from the company that requested them to serve in the Outside Position in addition to indemnification and insurance from the outside organization. Plus, in some situations a direct claim may be asserted against the requesting company based on its ability to influence the person serving in the Outside Position or based on information it obtained through that outside service. As a result, plaintiffs often now investigate whether a defendant director or officer is serving in that position at the request of another company and, if so, pursue the additional legal claims and deep pockets that are implicated by that individual’s service in the Outside Position.

An understanding and investigation of these unique liability issues is an important component of an effective executive liability loss prevention program. If left uncontrolled and unmanaged, Outside Position exposures can create significant, unintended, and unnecessary liability exposure to a company and its directors and officers. Although largely ignored for many years,
Outside Position claims are now being asserted with sufficient frequency and success that it behooves both the requesting company and the persons serving in the Outside Positions to understand and address the many factors that create this heightened liability exposure.

When properly managed, Outside Positions can serve as an important extension of corporate activity and provide valuable experience to the persons serving in the Outside Positions. If ignored, however, Outside Position exposures can result in unexpected and surprising liability exposures to the requesting company and its directors and officers. Some of those unique exposures and methods to manage those exposures are summarized below.

**Duty of Loyalty**

Outside Positions are often with entities that have common business interests or dealings with the company that requests the Outside Position service. These situations can be particularly problematic to the person serving in the Outside Position since that person has dual loyalties. In other words, plaintiffs can easily allege in many instances that the person serving in the Outside Position breached his or her duty of loyalty to the outside entity, to the requesting company, or to both. Some of the areas of concern in this regard and potential ways to mitigate those concerns include the following:

1. **Intercorporate Transactions**

   When a director or officer is on both sides of a transaction, he or she is required to demonstrate his or her utmost good faith and the “entire fairness” of the transaction. Courts will apply close scrutiny to determine whether that person’s actions were fair to both companies. In that type of duty of loyalty claim,
the Business Judgment Rule is likely not available to that person as a defense, and instead that person may have the burden to overcome a presumption that the transaction is invalid due to the conflict of interest.

In order to reduce this increased liability exposure, persons serving in Outside Positions should be especially vigilant to recuse themselves from the deliberations and approval of any transaction between the requesting company and the outside entity, or any other matter in which the interests of those two entities are or could be perceived to be in conflict. When in doubt, the person should be recused since perception is as important as reality in this context. This recusal should occur with respect to the decision-making process at both the requesting company and the outside entity.

2. Maintaining Confidences

Directors and officers of a company have a duty to use reasonable diligence to protect and safeguard the property of that company, including confidential information. If a director or officer either knowingly or inadvertently discloses confidential information to a third party, the director or officer can be liable for any resulting loss.

This liability exposure is particularly acute for persons serving in an Outside Position, who may be accused of disclosing confidential information about the requesting company to the outside entity, or disclosing confidential information about the outside entity to the requesting company. While acting as a director or officer of either company, the person must act solely in the best interest of that company regardless of any duties owed to the other company, and should not use confidential information obtained from the other company without the consent of that other company.
Outside Directors Liability Loss Prevention
Because it often is not entirely clear what constitutes confidential information for this purpose, a person serving in an Outside Position in an entity with similar interests to the requesting company runs the risk of unintentionally breaching this duty of loyalty to one or both companies by disclosing certain information to the other company. In order to reduce this liability exposure, persons serving in Outside Positions need to be constantly sensitive to what information may and may not be properly disclosed to each company. When in doubt, the person should inquire whether the information is confidential and should not disclose any potentially confidential information.

In addition, insider trading laws may be violated if the person serving in an Outside Position with a public company discloses material non-public information about the outside entity to others (including the requesting company) who then trade on that information. Again, information obtained from serving in the Outside Position must be strictly controlled and guarded.

3. Corporate Opportunity

A director or officer of a company may not usurp or misappropriate business opportunities belonging to that company if the company has a reasonable expectancy and capability to benefit from that opportunity. For example, a director or officer of a company may not personally or on behalf of another entity purchase property or a business that is offered or available to that company unless the company rejects or cannot accept the opportunity. This prohibition, which can involve a highly subjective analysis, is a particular concern for a person serving in an Outside Position because either the outside entity or the requesting company can contend the person usurped for the benefit of one of those companies a business opportunity available to the other company.
In order to reduce this increased risk, a person serving in an Outside Position should refrain from involving one company in a business opportunity until the other company that first identified the business opportunity fully abandons the opportunity and has provided written confirmation of its intent to abandon such opportunity.

4. Seek Legal Advice
Many of the increased liability exposures summarized above involve complex legal issues that require the assistance of qualified counsel to appreciate and analyze fully. Consistent with the inherent conflict that service in any Outside Position creates, persons serving in Outside Positions should routinely access independent legal counsel as appropriate to evaluate potential issues before actions are taken, not just when allegations of wrongdoing arise. This type of proactive management of these exposures, which should be funded by one or both of the companies, is essential to minimize even the perception of wrongdoing, particularly since many of these exposures are not readily apparent based on mere common sense.

Statutory Liabilities
Several statutes address liability issues related to Outside Positions, particularly so-called interlocking directorates in which a person serves as a director or officer of two or more companies which compete or are in the same industry. For example, the Federal Power Act generally prohibits an individual from being an officer or director
of more than one public utility, or from being an officer or director of a public utility and either a company that may underwrite or market public utility securities or that supplies electrical equipment to the utility, unless the Federal Energy Regulatory Commission authorizes such dual positions.

The broadest statutory regulation of Outside Position service is pursuant to Section 8 of the Clayton Act, 15 U.S.C. §19, which generally prohibits the same person from serving as an officer or director of two competing companies if both companies have capital, surplus, and undivided profits aggregating more than about $30,000,000 (this amount is adjusted annually based on the percentage increase or decrease of the GNP for the previous year). However, this prohibition does not apply to certain interlocking directorates, such as with a bank or with companies which compete only to a modest degree.

Even if the interlocking directorates' prohibition does not apply under the Clayton Act, other more general anti-trust statutory limitations may apply, so caution is needed whenever someone serves multiple companies in the same industry or with perceived similarities. The appearance of collusive behavior or inappropriate information sharing should be avoided in any context.

Issues under Section 8 of the Clayton Act can arise not only where the same person serves as a director or officer of competing firms, but also where a company appoints two different persons to serve as its representative on the boards of competing companies. Under certain circumstances, regulators have viewed the requesting company as the director of the outside entity, in which case the Section 8 interlocking directorate rules apply to that requesting company even though different persons
serve different competing companies at the request of the requesting company.

To minimize the potential for violation of these statutes, companies should include within their compliance programs a comprehensive process to at least annually monitor information relevant under these statutes, including:

- Who within the company serves as a director or officer of an outside entity described in these statutes?
- What are such outside entity’s assets, profits, capital position and sales of overlapping products?
- What businesses of the outside entity potentially compete with the requesting company (because this is not always obvious to senior management, front-line employees should be consulted for this information)?
- How does M&A activity by the requesting company or outside entity impact this analysis (acquisitions and spin-offs can create, increase or decrease competition between the companies and can change the relevant financial metrics)?

**Joint and Several Liability**
Most directors and officers (D&O) liability claims, if proven, create joint and several liability among the defendant directors and/or officers. Therefore, a plaintiff can choose to pursue any one or more of the defendant directors or officers for the entire amount of the liability imposed. Although all individuals and entities involved in the alleged wrongdoing are usually named as defendants, plaintiffs typically focus their recovery efforts on those individuals and entities that are perceived to have the deepest pockets, either by virtue of insurance coverage, indemnification protection, or net worth. Thus, persons serving in an Outside Position are frequently targets of
litigation due to the Outside Position insurance coverage and indemnification available from the requesting company, particularly if the outside entity maintains little or no D&O liability insurance coverage and has limited ability to indemnify the director and officer defendants.

This concern is usually not mitigated by the targeted defendant’s right in most cases to seek recovery from the other joint tortfeasors for their proportionate share of the total losses. Such a claim for contribution from the other defendants is frequently little more than a theoretical right. Asserting a contribution claim against one’s joint tortfeasors is difficult and expensive because, among other things, the target defendant must frequently try the underlying case in order to establish the validity and amount of the contribution claim. In addition, the joint tortfeasors may have limited resources and therefore be unable to pay the contribution claim even if proven.

**Liability of the Requesting Company**

The person serving in an Outside Position is not the only one who may incur increased liability exposure as a result of the Outside Position service. The requesting company may also encounter claims arising directly out of the outside service, as summarized by the following.

1. **Control Person**

   The requesting company may be directly liable for the conduct of the person serving in the Outside Position if the company has the right to control or actually exercises control over the person’s conduct in the Outside Position. This control person liability can be imposed under several different legal theories, including the control person provisions of the federal securities laws or the common-law theory of respondeat superior (i.e., a party is responsible for the acts of its agent).
2. Deputization Theory

When a company requests a person to serve in an Outside Position, the requesting company may incur entity liability exposure if that person is considered the “deputy” of the requesting company. In that event, the requesting company itself may be considered the person serving in the Outside Position (i.e., the de facto director or officer of the outside entity) and may have the same direct liability exposure as any natural person serving in that Outside Position. This deputization theory has been recognized by some courts and can create uninsured entity liability exposures for the requesting company since such a direct claim against the requesting company is usually not covered, particularly under a public company D&O liability insurance policy.

In order to mitigate this direct company exposure, the requesting company should clearly document, particularly with respect to Outside Positions that the requesting company has the legal right to fill, that (a) the requesting company disclaims any right or intent to direct or influence the decisions of the person serving in the Outside Position and, in fact, does not direct or influence such decisions, and (b) the person is not acting as an agent, representative or deputy of the requesting company while serving in the Outside Position. Similarly, the person serving in the Outside Position should not, in fact, be directed or influenced by others within the requesting company with respect to his or her decisions in the Outside Position, and should represent only the best interests of the outside entity while acting in the Outside Position.
3. Capacity

A director or officer who incurs loss as a result of service in an Outside Position may be considered to have incurred that loss in his or her capacity as a director or officer of the requesting company and thus be entitled to insurance and indemnification protection from the requesting company, even if no Outside Position indemnification or insurance is afforded by the requesting company. The courts that adopt this conclusion reason that the person who serves in the Outside Position is doing so because he or she is director or officer of the requesting company and therefore is fulfilling his or her duties as director and/or officer of the requesting company when serving in the Outside Position.

In order to mitigate this risk of unintended Outside Position indemnification or insurance obligations, the requesting company should clearly document when requesting Outside Position service that the person serving in the Outside Position is not doing so in his or her capacity as a director or officer of the requesting company.

Indemnification Issues

Difficult and surprising indemnification issues arise with respect to financially protecting persons who serve in Outside Positions. These issues should be identified and addressed when the outside service commences, not when allegations of wrongdoing are made, since it may be too late then to provide the maximum protection. When evaluating and planning for Outside Position indemnification, the indemnification rights and
obligations of both the outside entity and the requesting company must be considered. This section summarizes many of the important considerations with regard to indemnification from each company.

**Indemnification from Outside Entity**

Like any director or officer of the outside entity, a person serving in an Outside Position should confirm that the outside entity is obligated to indemnify that person to the fullest extent permitted by law. This analysis requires a review of both the applicable state law and the outside entity’s internal indemnification provisions contained in the entity’s certificate of incorporation, bylaws, or individual indemnification agreement. The most important provisions to maximize indemnification rights include:

- The internal indemnification provision should provide for indemnification “to the fullest extent permitted by law.”
- The provision should require indemnification, rather than merely permit the outside entity to indemnify.
- In addition to requiring indemnification, the provision should also require the advancement of defense expenses, subject only to an unsecured obligation to repay the expenses if a court subsequently determines indemnification is not permitted.
- The provision should apply not only to civil proceedings against the person, but also to any criminal, administrative, or investigative proceedings, any investigations, any written demand, any threatened claim, and any matter in which the person is called as a witness.
Other provisions can further enhance indemnification rights:

- A provision could require indemnification of any loss incurred by the person, including not only defense costs, settlements, and judgments, but also fines and penalties.
- A provision could state that if a dispute arises regarding the person’s right to indemnification, the entity has the burden to prove that the director or officer is not entitled to the requested indemnification.
- A provision could create a presumption that the person’s conduct qualifies for indemnification if the person relied upon the advice of other officers or outside advisors.
- A provision could require the entity to reimburse the director or officer for any expenses incurred by him or her in a proceeding against the entity to enforce his or her indemnification rights if the director or officer is successful in whole or in part in that indemnification enforcement proceeding.
- A provision could provide that the director or officer has a right to an appeal or an independent de novo determination as to indemnification entitlement if the entity refuses to indemnify.
- A provision could expressly state that the indemnification rights constitute a contract, apply retroactively to events occurring prior to their adoption, and shall continue to exist after the rescission or restrictive modification of the provision with respect to events occurring prior to that rescission or modification. Alternatively, a separate indemnification contract could be executed by the entity and the director or officer that likewise prohibits a retroactive rescission or restrictive modification of indemnification rights.
Outside Directors Liability Loss Prevention

Indemnification from the Requesting Company
Virtually every state indemnification statute permits corporations to indemnify persons serving at the request of the corporation as directors, officers, employees, or agents of an outside entity. The Delaware statute is typical and states in relevant part as follows:

A corporation shall have power to indemnify any person who was or is a party...to any threatened, pending or completed action, suit or proceeding...by reason of the fact that the person...is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise...if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation. (Section 145(a), Delaware General Corporation Law)

The following summarizes some of the important aspects of this and other similar Outside Position indemnification statutes that should be considered when evaluating the protection of persons serving in Outside Positions.

1. Protected Persons
The statute applies to any person (not just to directors and officers of the requesting company) serving in an Outside Position at the request of the company. Similarly, the statute applies to any position with an outside entity. Although the term “outside directorship” is frequently used to describe an Outside Position, that phrase is somewhat of a misnomer because a person serving at the request of the corporation as a director, officer, employee, or agent of the outside entity is eligible for protection from the requesting company. For example, if a person provides consultation or other assistance to an outside entity
at the request of a company, that person may become an agent of the outside entity, in which case Outside Position indemnification protection may apply. Also, the statute applies to service with any enterprise, including a corporation, partnership, joint venture, trust, and employee benefit plan.

2. Request

The statute does not require the service in the Outside Position to be at the written request of the company. Presumably, an oral request, if sufficiently proven, can trigger the indemnification authorization. Similarly, the statute does not require the request for Outside Position service to be by the company’s board of directors, officers, or any particular person. Presumably, any person with actual or apparent authority to bind the company can make the request on behalf of the company.

In light of the foregoing, anyone with an expectation of Outside Position indemnification protection may have a basis for contending the Outside Position service was at the request of the company since the statute alone contains virtually no controls or limitations regarding the form or source of that request. For example, comments by an employee’s superior or written policy statements encouraging employees to be active in civic or community organizations or suggesting to employees that they “support” or “help out” another entity may be sufficient to invoke Outside Position indemnification protection.
3. Excess of Outside Entity Indemnification
The statute does not address the relationship between indemnification available from the requesting company and from the outside entity for the same loss. Typically, the intent is that the requesting company’s indemnification is excess of the outside entity’s indemnification, but that result will not necessarily occur unless the requesting company’s by-laws indemnification provision so states.

4. Indemnified Claim
The statute applies to any type of claim against a person serving in an Outside Position. When evaluating the requesting company’s exposure for Outside Position indemnification, one should consider not only claims for breach of duty and statutory violations that are typically covered under a D&O liability insurance policy, but also claims typically excluded by D&O liability insurance. For example, bodily injury and property damage claims against the person serving in an Outside Position can create potentially enormous indemnification liability to the requesting corporation, particularly if the outside entity maintains no or inadequate general liability insurance coverage. The requesting corporation’s general liability insurance may not cover this exposure because such insurance typically is silent on the matter of Outside Position coverage, thus creating a potentially large uninsured liability exposure for the requesting company.
5. Mandatory Indemnification
The Delaware statute cited on page 12, like many other state indemnification statutes, merely permits but does not require companies to indemnify Outside Position losses. However, many companies restate verbatim the state indemnification statute in their by-laws and simply change permissive words such as “may” to mandatory words such as “shall” in order to mandate the statutorily authorized indemnification. Other companies mandate indemnification “to the fullest extent permitted by law.” Under either of those types of indemnification provisions, this extremely broad and largely uncontrolled Outside Position indemnification exposure becomes a legal obligation of the requesting company, thereby subjecting the company to a myriad of potential indemnification claims that may not be foreseen by the corporation.

When designing an appropriate Outside Position indemnification provision, a company must balance the legitimate interests of the company to avoid unintended indemnification liabilities in light of the broad Outside Position indemnification statute, on the one hand, and the legitimate desire of the person serving in the Outside Position to obtain maximum financial protection for that outside service, on the other hand. Each of the elements of the statute summarized above should be considered when deciding what Outside Positions the company should and should not be required to indemnify. Ultimately, that balance may be best achieved by implementing a formalized Outside Position Program, as described below, and linking the corporation’s Outside Position indemnification obligations in its internal indemnification documents to that formal Outside Position Program.
D&O Liability Insurance Issues

Like indemnification, quality insurance coverage from both the outside entity and the requesting company are important components of a financial protection program for persons serving in Outside Positions. Before accepting an Outside Position, the person should request a copy of the outside entity’s D&O liability insurance policies and should utilize the assistance of a knowledgeable advisor to evaluate the quality of the coverage and the adequacy of the limits of liability afforded by that insurance program.

Equally important is the D&O liability insurance coverage afforded by the requesting company. Absent special provisions in the requesting company’s D&O policies, claims against directors and officers for wrongful acts while serving in an Outside Position are not typically covered under the requesting company’s policy since service in the Outside Position would be in an uninsured capacity. However, many, but not all, D&O policies include special provisions that extend coverage for insured persons who serve in certain types of Outside Positions under certain circumstances. The scope of coverage afforded by those provisions can vary greatly among policies. Therefore, it is very important for both the requesting company and the insured person to determine and obtain from the insurers the preferred provisions. Because the interests of the requesting company and the insured person may conflict to some extent with respect to these issues, an important initial question is who will make the ultimate decision regarding what type of Outside Position coverage is purchased.

This section summarizes many of the issues that should be considered when evaluating this Outside Position coverage within the requesting company’s D&O liability insurance program.
**Company Request**  
Policies differ as to what type of Outside Position request by the company will trigger the Outside Position coverage. At one extreme, some policies require a written request by the company that the insured person serve the Outside Position. Other, more liberal policies recognize coverage if the Outside Position service is with the knowledge and consent of, at the direction or request of, or part of the duties regularly assigned to the insured person by the requesting company. At a minimum, the insurance policy language describing this request should encompass the type of request required by the company’s indemnification provision so that the company will have coverage if it indemnifies someone serving in an Outside Position.

**Insured Persons**  
Policies differ with respect to the types of persons who are covered while serving in an Outside Position. Many policies cover any director or officer of the company who serves in an Outside Position. Other policies are more liberal and afford this coverage to any person (not just a director or officer) who serves in the Outside Position at the request of the company. A much more restrictive approach affords this coverage only for individuals specifically listed by endorsement or only to certain types of senior executives. This more restrictive approach most often applies to Outside Positions in a for-profit company.

**Type of Outside Position**  
Policies differ with respect to what types of positions in an outside entity are covered. Many policies cover service as a director, officer, governor, trustee, manager, or other equivalent executive position with the outside entity. Other more liberal provisions also cover service as an employee or agent of the outside entity.
Type of Outside Entity
Policies differ as to the type of outside entity in which the outside service is performed. Most policies extending coverage for service in Outside Positions include Outside Positions in nonprofit entities that are exempt from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code (i.e., charitable outside entities). Other, more liberal policies extend this coverage to Outside Positions in any tax-exempt Section 501(c) entity or, perhaps, any entity chartered as a nonprofit organization, although certain types of higher-risk nonprofit entities, such as hospitals and financial institutions, may need to be specifically listed to be covered. Typically, coverage for Outside Positions in for-profit organizations -- particularly publicly-held for-profit organizations -- applies only if the specific for-profit organization (and perhaps the specific person serving in the Outside Position with the specific for-profit outside entity) is listed in an endorsement, thereby allowing the insurer to underwrite the risks associated with that outside for-profit entity. However, many “Side A” D&O insurance policies cover Outside Positions in any for-profit entity.

Double vs. Triple Excess Coverage
All policies state that any Outside Position coverage in the requesting company’s policy is expressly excess of any indemnification available from and any insurance maintained by the outside entity. This is frequently described as “double excess” Outside Position coverage. A more limited type of Outside Position coverage insures only Outside Position losses that are also not indemnified by the requesting company. This type of more limited coverage is frequently described as “triple excess” (i.e., excess of both insurance and indemnification from the Outside Entity and excess of the requesting company’s indemnification).
**Insured vs. Insured Exclusion**

Some policies contain an exclusion that eliminates Outside Position coverage for claims by or on behalf of the outside entity and perhaps the directors and officers of the outside entity. This type of exclusion is similar to the standard “insured-versus-insured” exclusion in D&O policies, but frequently does not have all of the carve-outs to the exclusion that are typically contained within the D&O policies’ standard insured-versus-insured exclusion. More liberal policies do not contain any form of this exclusion.

**Limit of Liability**

Policies differ with respect to the available limit of liability for Outside Position claims. Many policies contain a provision that prevents the insurer from paying multiple limits for a single claim if the insurer issues a D&O policy to both the requesting company and to the outside entity. Under such a provision, the insurer’s maximum liability under both policies combined for any one Outside Position claim would be the largest available limit of liability under either policy. This type of limit of liability tie-in provision may reduce or eliminate coverage for Outside Position claims in the requesting company’s excess D&O policies, since those excess policies are typically triggered only if the full amount of the requesting company’s underlying D&O limits of liability are paid in full, regardless if those underlying limits are discounted by reason of a limit of liability tie-in provision. In other words, a limit of liability tie-in provision in the primary D&O policy may create a gap in coverage in the excess D&O policies to the extent the primary insurer pays less than its full limit of liability by reason of the tie-in limit provision (i.e., the excess policies typically do not drop down to fill that gap).
International Issues
If the Outside Position is with an entity chartered or located outside the United States, far less consistency and certainty exists with respect to the terms and adequacy of the Outside Position financial protection program. Under the indemnification laws of many foreign countries, it is unclear at best and perhaps illegal for the requesting company to indemnify persons serving in an Outside Position. Even indemnification from the outside entity may be much less certain since many foreign countries do not have well-defined indemnification laws. In addition, many foreign companies do not maintain D&O liability insurance for various reasons. As a result, the existence and quality of the requesting company’s Outside Position insurance in that foreign context may be quite important.

Managing Outside Position Exposures
All of the many loss prevention practices applicable to directors and officers of for-profit and nonprofit organizations are equally applicable to managing Outside Position exposures. Persons should serve in Outside Positions in full recognition of the potentially severe exposures they may incur if things go wrong. Too often that reality is overlooked, either because the person serving in the Outside Position views his or her role with the outside entity as less demanding and significant than other responsibilities or because the person lacks sufficient experience to fully appreciate all of the consequences associated with serving in the Outside Position. Persons serving in Outside Positions should be educated, reminded, and sensitized, not only to the unique loss prevention issues addressed in this booklet, but also to the many standard D&O liability loss prevention concepts applicable to any director or officer. For example, the Chubb Group of
Insurance Companies publishes a series of D&O liability loss prevention booklets that address numerous loss prevention concepts for independent directors, for directors and officers of for-profit and nonprofit organizations, for securities litigation, for ERISA fiduciaries, for employment practices and for cyber-related exposures.

In addition to those common D&O practices, two loss prevention topics that are especially important with respect to Outside Positions relate to (1) evaluating the risk profile of a specific Outside Position before accepting that position and (2) maintaining a comprehensive process by which a company requests persons to serve in Outside Positions. Each of those loss prevention opportunities is discussed here.

**Evaluate Outside Position Risks**

Prior to accepting a board or management position with an outside entity, a person should carefully consider the risk profile of that Outside Position. A number of factors may influence the level of risk associated with serving in the Outside Position with that entity, including:

- The financial performance and stability of the outside entity.
- The experience and quality of current management, directors, and the professional advisors for the outside entity.
- The existing governance practices of the outside entity, such as: the board size and composition, the type of board committees and their degree of activity as reflected in their charters and actual practice, the type and depth of information routinely provided to the board, and the frequency and quality of board meetings.
- The effectiveness of the outside entity’s efforts to identify and manage the entity’s most important risks.
• The outside entity’s industry, including the volatility, level of competition, and extent of government regulation within that industry.
• Any past claims against the outside entity and its directors and officers.
• The frequency of management, director, and auditor turnover.
• The general reputation of the outside entity and its CEO.
• The executive compensation practices of the outside entity.
• The quality of the outside entity’s D&O indemnification and insurance programs.

The more information the person can obtain about the outside entity and the Outside Position before accepting that position, the better informed the person’s decision will be. If the outside entity is reluctant or unwilling to provide the requested information, that alone is certainly grounds for concern.

**Selectively Approve Outside Service**
In order to help control and manage the potentially large but unknown liability exposure arising out of persons serving at the request of a company in Outside Positions, the company should develop, implement, and maintain a comprehensive Outside Position program that formalizes and documents the process by which a company decides whether to financially support persons serving other organizations. The proper program for any particular company will depend on factors unique to that company. The following summarizes some of the elements of a sample Outside Position program. Sample forms to consider when implementing such a program are shown at the end of this document as Exhibits A, B, and C.
1. Establish Management Support
An essential component of a comprehensive Outside Position program is the support of senior management, which should be solicited at an early stage of the program’s development. Senior management input will be important in formulating certain components of the program, including selection of the program administrator and criteria for approving Outside Positions. In addition, the support of senior management will be helpful in giving the program credibility and legitimacy.

2. Develop a Program
The two primary components of an Outside Position Program are (1) the criteria/guidelines to be used in determining whether an Outside Position will be approved and (2) the program decision makers (persons/committee) that will administer the program.

The criteria/guidelines should reflect the company’s philosophy towards its presence and involvement in the community, as well as business-related networking and service. The criteria should be specific enough to be a meaningful tool in making approval decisions, yet flexible enough to apply to various unexpected situations. Different criteria depending upon the type of outside organization will probably be required—for example, the criteria for approving service on the board of a charitable organization will be different than the criteria for approving service on the board of a trade association or portfolio company. Likewise, a company
may choose to grant automatic blanket approval for some types of Outside Positions—for example, directors or officers of a parent company who also serve as a director or officer of a subsidiary company could automatically qualify for Outside Position indemnification protection from the parent company without having to obtain express approval for such service.

The program decision makers can be a committee of the board of directors, one or more members of senior management, the risk management department, representative employees, or any combination of the foregoing. Regardless of who the decision makers are, the risk management, legal, or other similar department should be designated as the administrator of the program for purposes of developing, handling, and retaining documentation.

The company’s internal indemnification provision and D&O liability insurance policies should also be reviewed for any necessary amendments to reflect the existence of the program. A fundamental purpose of the program is to limit the company’s indemnification obligation and insurance coverage only to those persons whose outside service is approved pursuant to the program. That goal typically is not achieved unless the indemnification provisions and insurance policies expressly limit Outside Position protection to only persons and positions approved pursuant to the program.
3. Publicize the Program

Exhibit A (on page 35) presents a sample communication to employees concerning Outside Positions and the program. This communication has three primary purposes.

First, employees are made aware of the duties they assume by serving in an Outside Position and the resulting personal liability risk. Although it is not practical for this type of communication to contain a summary of applicable law and various loss prevention concepts, the risk management or legal department can serve as a clearinghouse for materials addressing those issues. For example, this booklet is available for distribution, as are complementary booklets published by Chubb that address the responsibilities of directors and officers and loss prevention techniques in the context of for-profit corporations, nonprofit organizations, securities litigation, independent directors, ERISA fiduciaries, employment practices and cyber-related exposures.

The second primary purpose of the communication to employees is to educate the employees about the various methods potentially available to protect themselves financially from loss arising out of service in an Outside Position. Indemnification and insurance protection from the outside organization should be viewed as the first line of defense, with the requesting company’s Outside Position indemnification and insurance serving only as backstop protection. Conversely, the communication to employees informs the employees that they will not have indemnification or insurance protection through the company unless their outside service is specifically approved pursuant to the program.
The third primary purpose of the communication is to invite employees to seek the company’s consent and approval for their outside service, thereby allowing the company to manage and control its Outside Position related exposures. Most companies are shocked to learn through this process the number of employees who are serving in Outside Positions with the expectation of financial support from the company. Creating better clarity as to the company’s position with respect to each of those Outside Positions can avoid surprises to both the company and the employee if a claim is later made against the employee in that outside capacity.

4. Implement the Program
   Exhibit B (on page 38) shows a sample questionnaire that employees can use when requesting participation in the program. It may be preferable that the questionnaires be solicited, received, and approved/disapproved during a designated period each year rather than continuously throughout the year. If that “enrollment” period corresponds to the company’s D&O liability insurance renewal date, a timely and complete request for Outside Position insurance coverage would be possible. The questionnaire ultimately used by the company should anticipate questions that the D&O liability insurer will likely ask in its Outside Positions underwriting process.

   Exhibit C (on page 25) shows a sample approval/disapproval form, which could be used by the decision makers to reflect the action taken for each submitted questionnaire. Copies of such a form could be both retained by the program administrator and returned to the employee. Any approval could either be indefinite or limited to one year, subject to renewal upon resubmission of a questionnaire.
Conclusion

Companies should be mindful to manage the risks associated with their directors, officers, and employees serving at the company’s request in an Outside Position with another entity. That service can create unique and acute liability exposures for the persons serving in the Outside Position as well as for the requesting company. However, those exposures can be managed if prudent procedures are implemented and if appropriate indemnification and insurance protections are maintained.

Unfortunately, those risk management practices usually do not exist at a company unless the board and senior management have recognized the concerns and taken specific actions to minimize the exposures and to ensure that properly tailored indemnification and insurance protection exists. As with many other governance issues, the use of knowledgeable outside advisors may be necessary to evaluate and address these issues. At a minimum, directors and senior officers should inquire about the extent to which the company has addressed these issues.
Sample Employee Communication

Exhibit A
XYZ Inc. recognizes that some of its employees may wish to contribute their time and talents as leaders in certain community or other outside organizations. This service not only represents good corporate and personal citizenship, but it can also result in personal growth and fulfillment.

Unfortunately, these outside activities may carry varying degrees of risk of personal liability, particularly if you serve as a director or officer of the outside organization. This communication is intended to help you reduce that risk of liability and maximize your financial protection in the event you incur loss as a result of that outside service.

Understand Your Legal Responsibilities
Depending on the type of outside organization you serve and the position you hold, various legal duties may be imposed on you in your outside position. It is incumbent upon you to understand those obligations since it is obviously difficult to comply with the law if you do not know what the law requires. The XYZ Inc. [Risk Management or Legal] Department has some general background information concerning these legal obligations for various types of organizations, as well as materials suggesting numerous loss prevention concepts and techniques that may help to minimize one’s director or officer liability exposure. Please contact [Name] in the [Risk Management or Legal] Department to request a copy of any of these materials.
Financial Protection

1. Protection from Outside Organization
   You may be entitled to indemnification from the outside organization for any loss you incur as a result of your service to that organization. We encourage you to review the scope of this protection by examining the indemnification provision that is likely found in the organization’s charter or by-laws. In particular, we suggest that you determine whether the organization is required or simply permitted to indemnify you, what losses are and are not included within the indemnification, and the organization’s likely financial ability to fund the indemnification.

   The outside organization may also maintain directors and officers (D&O) liability insurance. If such insurance is purchased, you should determine its limits of liability, deductible, and breadth of coverage. This insurance will likely not cover claims for bodily injury or property damage; therefore, you should also determine whether the organization maintains general liability insurance coverage and the scope of protection under any such policy.

2. Protection from XYZ Inc.
   Under some circumstances, XYZ Inc. will agree to indemnify an employee who is serving with the consent of the Company in an outside position. XYZ Inc.’s insurance program may also be available to provide protection to such an employee. This indemnification and insurance is in addition to (or “excess” of) any indemnification and insurance protection available through the outside organization.

   If you are interested in seeking this indemnification and insurance protection from XYZ Inc. for an outside position, you must complete and submit an Employee
Outside Position Questionnaire, copies of which are available from the [Risk Management or Legal] Department. Your questionnaire will be reviewed in light of existing guidelines, and you will be informed if your outside position has been approved as qualifying for inclusion within XYZ Inc.’s outside position indemnification and insurance program. If approved, you should submit an updated questionnaire annually to maintain your inclusion within the program. If not approved, you will not be entitled to indemnification or insurance through XYZ Inc. with respect to your service in the outside position.

If you have any questions concerning any of these matters, please contact [Name] in the [Risk Management or Legal] Department.
Employee Outside Position Questionnaire

Exhibit B
XYZ Inc. understands that some of its employees may wish to contribute their time and talents as leaders in certain community and other outside organizations. Because this outside service can conceivably result in your personal liability, XYZ Inc. maintains an Outside Position Indemnification/Insurance Program. Subject to its terms and conditions, this program is intended to provide to any employee who serves in an approved outside position certain financial protection against personal liability arising out of that outside service.

If you are seeking inclusion within XYZ Inc.’s Outside Position Indemnification/Insurance Program, you must complete and sign this questionnaire for each outside position for which you seek approval. You will qualify for outside position indemnification and insurance through XYZ Inc. only if (a) you are notified in writing that your outside position is approved pursuant to guidelines maintained by XYZ Inc., and (b) loss results from your alleged wrongdoing in the outside position while you are an employee of XYZ Inc. If your outside position is approved, you should submit a renewal questionnaire annually to remain a participant in the program.

Please answer the following questions and return this questionnaire to [Name] by [Date].

1. Is this a ____ new or a ____ renewal questionnaire? (check one)

2a. Name of outside organization:
2b. Type of organization (check all applicable categories):

☐ For-Profit ☐ Financial Institution
☐ Publicly Owned ☐ Provide Professional Services
☐ Partnership/Joint Venture ☐ Portfolio Company
☐ Not-for-Profit ☐ High Tech or Bio Tech
☐ Charitable ☐ Medical/Health
☐ Educational ☐ Political Action
☐ Civic ☐ Religious
☐ Cultural ☐ Foreign Entity
☐ Professional or Industry Association ☐ Other (Describe)

3. What is the position you occupy or intend to occupy in the outside organization?

_________________________________________________________________________________________________

4. What is the nature of your duties/responsibilities in the outside position?

_________________________________________________________________________________________________

5. What are the purpose and scope of activities of the outside organization? (Attach brochure or other descriptive document if available.)

_________________________________________________________________________________________________

6. Do the outside organization’s governing documents require indemnification of the outside position?
___ Yes (please attach)  ___ No

7. Does the outside organization provide directors and officers liability insurance?

___ Yes  ___ No

If yes, indicate the total amount of coverage: $ ______________

8. (Optional) Please attest to the following:

A. No claim has been made or is now pending against me, and I am not aware of any fact, circumstance, or alleged wrongdoing that could reasonably give rise to a future claim against me, as a result of my service in the Outside Position, except as follows:

Check one: ___ No exception  ___ Exception (Please explain below):

_______________________________________________________________________________________________________
_______________________________________________________________________________________________________

B. I agree to promptly notify the [Risk Management or Legal] Department if, after signing this questionnaire, I become aware of any claim, threat of claim, or situation that could reasonably give rise to a claim against me as a result of my service in the outside position.

The undersigned declares that to the best of his/her knowledge and belief the statements set forth herein are true and accurate, and understands that intentional concealment of facts or material misrepresentation on this questionnaire may invalidate the indemnification and/or liability insurance, if any, provided by the Company.

The undersigned understands and agrees that if the Company provides indemnification and/or insurance with respect to an outside position, such
protection will be subject to the terms and conditions of such indemnification and insurance, and will be specifically excess of any indemnity or insurance provided by the outside organization.

Signature ____________________________________________

Print ________________________________________________

Employer/Job Title ______________________________________

Date __________________________________________________
Exhibit C

Employee __________________________________________________________

Outside Organization ________________________________________________

Outside Position ____________________________________________________

It is hereby determined that the above-referenced Employee’s service in the
above-referenced Outside Position for the Outside Organization listed above is:

APPROVED/DISAPPROVED (circle one)

If approved:

a. The Employee shall be deemed to be serving in such outside position at the
request of XYZ Inc. and shall be entitled to the indemnification protection and
director and officer liability insurance coverage, if any, afforded or maintained by
XYZ Inc. for such service.

b. Such indemnification and insurance protection shall be excess of any
indemnification and insurance available from or through the outside organization.

c. Such indemnification and insurance protection shall terminate as of the earlier
of (a) cessation of the Employee’s employment with XYZ Inc. for any reason, or
(b) any anniversary of this approval if the Employee has not submitted a Renewal
Questionnaire and obtained an annual extension of the approval.

d. While serving in the outside position, the Employee is not acting as an agent,
representative, or deputy of XYZ Inc. and is not acting in his or her capacity as a
director, officer, or employee of XYZ Inc. XYZ Inc. disclaims any right to direct or
influence the actions of the Employee while serving in the outside position.
If disapproved:

a. The Employee is not serving in the outside position at the request of or with the consent of XYZ Inc.

b. The Employee is not entitled to any indemnification or insurance protection from or through XYZ Inc. for service in the outside position for the outside organization.

Date ___________  Authorized Signature ________________________________
About the Author

Dan A. Bailey, Esq., a member of the Columbus, Ohio, law firm Bailey Cavalieri LLC, is one of the nation’s foremost experts on matters relating to directors and officers (D&O) liability, litigation, and insurance. He and his firm have represented or served as consultant to a wide variety of directors and officers, companies, insurance companies, insurance brokers, and law firms around the country regarding D&O matters.

A frequent speaker at seminars regarding D&O liability and insurance, Mr. Bailey is also the coauthor (with William E. Knepper) of Liability of Corporate Officers and Directors (8th edition, 2017), and he has written dozens of articles on the subject.

Mr. Bailey received his B.S. degree in business administration cum laude from Bowling Green State University in 1975 and was awarded a Juris Doctor degree with honors from the Ohio State University College of Law in 1978. He is a member of numerous honoraries and was selected for inclusion in Who’s Who in America.
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This booklet is necessarily general in content and intended to provide an overview of certain aspects of corporate governance and has an edition date of July, 2017. This document is advisory in nature and is offered as a resource to be used together with your legal and professional insurance advisors in maintaining a corporate governance or loss prevention program. The views, information and content expressed herein are those of the author and do not necessarily represent the views of Chubb. The information provided should not be relied on as corporate governance or other legal advice, or insurance advice, or a definitive statement of the law in any jurisdiction. For such advice, an applicant, insured, or reader should consult their own legal counsel and insurance consultant. No liability is assumed by reason of the information this document contains. Form ###-#### (Rev. 03/18)