

TABLE OF CONTENTS

CHAPTER 1

Duties of Directors and Officers

§ 1.01	General Nature of Duties of Officers and Directors.	1-3
§ 1.02	Duty of Loyalty.	1-8
[1]	Definition and Purpose of the Duty of Loyalty.	1-8
[2]	Sources of the Duty of Loyalty.	1-9
[a]	State Corporation Laws	1-10
[b]	Common Law and the Business Judgment Rule	1-13
[c]	Charter and Bylaw Provisions.	1-13
[3]	Forms of Breach of the Duty of Loyalty.	1-14
[a]	Conflict of Interest.	1-14
[b]	Usurpation of Corporate Opportunity	1-15
[c]	Failure to Disclose Material Facts	1-17
[d]	Improper Use of Confidential Information.	1-18
[e]	Personal Advantage and Secret Profits	1-19
[f]	Illegal Acts and Failing to Act	1-20
[4]	The Common Law Doctrine of Shareholder Ratification	1-20
§ 1.03	Duty of Care	1-22
[1]	Standard of Care Defined	1-22
[a]	Delaware.	1-23
[b]	Model Act State Laws	1-25
[c]	Non-Model Act State Laws.	1-26
[2]	Negligence	1-26

DIRECTORS AND OFFICERS LIABILITY

	[3]	Matters Affecting or Limiting the Duty of Care	1-28
	[a]	Reliance on Others	1-28
	[b]	Statutes and Charter Provisions Limiting Director and Officer Liability	1-30
§ 1.04		Other Duties	1-32
	[1]	Duty of Disclosure	1-32
	[2]	Duty to Creditors	1-34
	[3]	Duties During Chapter 11 Bankruptcy	1-36
§ 1.05		The Business Judgment Rule	1-38
	[1]	Definition and Purpose	1-38
	[2]	The Business Judgment Rule in Detail	1-41
	[a]	Business Decision	1-42
	[b]	Disinterestedness and Independence	1-42
	[c]	Duty of Loyalty	1-47
	[d]	Duty of Care	1-48
	[e]	Limited Nature of Protection	1-50
	[3]	Standards Used When the Business Judgment Rule Does Not Apply	1-51
	[a]	The Enhanced Scrutiny Standard	1-51
	[b]	The Entire Fairness Standard	1-51
§ 1.06		Tender Offers, Mergers, and Other Change of Control Attempts	1-54
	[1]	Federal Securities Law Liability in Connection with Tender Offers	1-54
	[2]	Directors' Duty to Make Informed Decisions in Change of Control Transactions	1-56
	[3]	Defensive Measures in Response to Hostile Takeover Attempts	1-59
	[a]	The <i>Unocal</i> Standards	1-59
	[b]	Director Liability for Defensive Antitakeover Measures	1-61
	[4]	Director Duties in Auctions	1-63
	[5]	Settlement Considerations	1-66
§ 1.07		Other Sources of Direct Liability of Corporate Directors and Officers	1-68
	[1]	<i>Ultra Vires</i> Acts	1-68
	[2]	Illegal Acts	1-68
	[3]	Directors' Duties in Compensation Decisions	1-69
	[4]	Waste	1-71
	[5]	Board Duties and Cybersecurity	1-72

TABLE OF CONTENTS

vii

	[6] Board Duties and Diversity	1-74
§ 1.08	Committees of the Board of Directors	1-75
	[1] Committees for Particular Events	1-76
	[a] Special or Independent Committees	1-76
	[b] Litigation Committees	1-78
	[2] Standing Committees	1-78
	[a] Audit Committee	1-78
	[i] Role of Audit Committee	1-78
	[ii] Rules Relating to Audit Committees	1-79
	[iii] Securities & Exchange Commission Rules	1-83
	[iv] Changes Under the Sarbanes-Oxley Act of 2002	1-84
	[b] Nominating Committee	1-87
	[c] Compensation Committee	1-88
	[d] Executive Committee	1-89

CHAPTER 2

Derivative Litigation

§ 2.01	Overview	2-2
§ 2.02	Distinction Between Derivative and Direct Claims	2-4
	[1] Definitions	2-4
	[2] Derivative Claims	2-6
	[3] Direct Claims	2-10
	[4] Simultaneous Derivative and Direct Claims	2-15
	[5] Special Considerations for Directors and Officers in Settlement Negotiations	2-16
§ 2.03	Procedural Aspects of Derivative Litigation	2-18
	[1] Pleading Requirements	2-18
	[a] Federal Rules	2-18
	[b] State Procedural Rules	2-20
	[2] Pleading with Particularity	2-21
	[a] Particularity Defined	2-21
	[b] Rigorous Interpretation in Derivative Actions	2-22

DIRECTORS AND OFFICERS LIABILITY

	[c]	State Law Claims Brought in Federal Court	2-23
	[3]	The Right to a Jury Trial.	2-23
	[a]	Seventh Amendment Right	2-23
	[b]	State Law Rights	2-24
	[4]	Requirement to be a Shareholder	2-24
	[5]	Loss of Standing in Merger Situations and Bankruptcy.	2-26
	[6]	Statutes of Limitations.	2-28
	[7]	Discovery Issues.	2-29
§ 2.04		Bringing a Derivative Suit	2-30
	[1]	Demand Requirement.	2-30
	[a]	Definition and Purpose	2-30
	[b]	Making a Demand	2-32
	[2]	Demand Futility	2-34
	[a]	<i>Aronson</i> Test for Demand Futility	2-35
	[b]	<i>Rales</i> Test for Demand Futility	2-37
	[c]	Demand Futility in New York.	2-39
	[d]	Model Business Corporation Act	2-40
	[e]	Demand Futility and Collateral Estoppel	2-41
	[f]	Situations in Which Demand Is Not Excused as Futile	2-42
	[g]	Situations in Which Demand Is Excused	2-44
	[3]	Adverse Domination Doctrine.	2-45
	[4]	Special Litigation Committees	2-46
	[a]	Purpose	2-46
	[b]	Formation and Operation of Special Litigation Committees.	2-47
	[i]	The Decision to Form a Committee	2-47
	[ii]	Disinterested Members.	2-47
	[iii]	Standards of Review in Examining the Decisions of Special Litigation Committees.	2-49
	[iv]	Hiring of Counsel and Other Experts	2-49
	[v]	Special Litigation Committee Communications and Written Reports	2-50

CHAPTER 3

Class Action Litigation

§ 3.01	Direct Actions and Shareholder Class Actions	3-3
§ 3.02	Federal Securities Laws	3-6
§ 3.03	Common Features of the 1933 and 1934 Acts	3-7
	[1] Secondary Liability: Control Person Liability	3-7
	[a] Elements	3-7
	[b] Definition of “Control”	3-8
	[c] “Culpable Participation” Requirement	3-9
	[d] Defenses	3-10
	[2] Secondary Liability: <i>Respondeat Superior</i>	3-11
	[3] Statute of Limitations	3-12
	[4] <i>In Pari Delicto</i> Defense	3-13
§ 3.04	Corporate Director and Officer Liability Under the 1933 Act	3-14
§ 3.05	Liability for Lack of Required Registration—Section 12(1)	3-19
	[1] Registration Requirements	3-19
	[2] Potential Plaintiffs and Defendants	3-19
	[3] Remedies	3-20
§ 3.06	Liability for Material Misstatement or Omission in a Prospectus or Oral Offer for Sale—Section 12(2)	3-22
	[1] Elements	3-22
	[2] Potential Plaintiffs and Defendants	3-24
	[3] Defenses and Burdens of Proof	3-25
	[4] Remedies	3-26
§ 3.07	Material Misstatements or Omissions in Registration Statements—Section 11	3-27
	[1] Elements	3-27
	[2] Potential Plaintiffs and Defendants	3-29
	[3] Defenses	3-31
	[4] The Due Diligence Defense	3-31
	[5] Remedies	3-33
§ 3.08	Fraud Under the 1933 Act—Section 17(a)	3-34
	[1] Elements	3-34
	[2] Defenses	3-35
	[3] Remedies	3-35

DIRECTORS AND OFFICERS LIABILITY

§ 3.09	Corporate Director and Officer Liability Under the 1934 Act	3-37
§ 3.10	General Antifraud Provision—Section 10(b)	3-38
	[1] Liability of Secondary Actors	3-38
	[2] Elements	3-41
	[a] Relationship Between Section 10(b) and Rule 10b-5	3-41
	[b] Definition of “Sale”	3-43
	[c] Intent to Deceive or Defraud	3-43
	[d] Knowledge and Reliance	3-52
	[e] Loss Causation	3-55
	[3] Standing	3-58
	[4] Scope of Section 10(b) and Rule 10b-5	3-59
	[a] Options	3-59
	[b] Forward-Looking Statements	3-59
	[c] Duty to Disclose	3-61
	[5] Remedies	3-62
§ 3.11	Material Misstatements and Omissions in Proxy Statements—Section 14(a)	3-63
	[1] Elements	3-63
	[2] Remedies	3-65
§ 3.12	Tender Offers and Liability Under the Williams Act	3-66
	[1] Elements	3-66
	[2] Remedies	3-66
§ 3.13	Background of State Blue Sky Laws	3-68
	[1] Purposes of Blue Sky Laws	3-68
	[2] Federal and State Jurisdiction	3-69
§ 3.14	Control Person Liability Under State Blue Sky Laws	3-71
	[1] Definition of “Control Person”	3-71
	[2] Defenses	3-71
	[3] Participation Requirements	3-71
	[a] Participation Not Required	3-71
	[b] Participation Required	3-72
	[c] Definition of “Participation”	3-72
§ 3.15	Civil Liability Under State Blue Sky Laws	3-74
	[1] The Uniform Securities Act	3-75
	[2] The Uniform Securities Act of 1985	3-76
	[2A] The Uniform Securities Act of 2002	3-77
	[3] New York	3-78
	[4] California	3-79
§ 3.16	Applicability of State Blue Sky Laws	3-80
§ 3.17	Remedies for Breach of State Blue Sky Laws	3-82

CHAPTER 4

Other Liabilities of Directors and Officers

§ 4.01	Overview	4-2
§ 4.02	Common Law Liability.	4-3
	[1] Piercing the Corporate Veil.	4-3
	[2] Tort Liability	4-7
§ 4.03	Statutory Liability	4-10
	[1] Environmental	4-10
	[a] Comprehensive Environmental Response, Compensation, and Liability Act	4-10
	[b] Resource Conservation and Recovery Act	4-14
	[c] Federal Water Pollution Control Act.	4-16
	[d] The Clean Air Act	4-19
	[e] Oil Pollution Act of 1990	4-20
	[2] Employee Retirement Income Security Act of 1974.	4-21
	[3] Fair Labor Standards Act	4-30
	[4] Family and Medical Leave Act.	4-33
	[5] Tax	4-35
	[a] Payroll Withholding.	4-35
	[b] Other Tax Liability	4-37
	[6] Sarbanes-Oxley Act of 2002.	4-38
	[7] Dodd-Frank Wall Street Reform and Consumer Protection Act	4-43
§ 4.04	Criminal Liability	4-45
	[1] Criminal Fraud.	4-45
	[a] Racketeer Influenced and Corrupt Organizations Act	4-45
	[b] Mail and Wire Fraud Statutes	4-46
	[2] Criminal Counterparts to Statutory Civil Liability.	4-47
	[a] Occupational Health and Safety Act of 1970	4-48
	[b] Securities Acts	4-50
	[3] Foreign Corrupt Practices Act of 1977	4-50
	[4] Economic Espionage Act of 1996.	4-52
	[5] Antitrust Laws	4-54
	[a] The Clayton Act.	4-54
	[b] The Sherman Act.	4-54
	[6] Obstruction of Justice	4-55

§ 4.05	Bankruptcy Liability	4-57
	[1] Preferential Payments	4-57
	[2] Fraudulent Transfers	4-58
	[3] Fiduciary Duty to Creditors	4-60
	[4] Criminal Liability	4-62

CHAPTER 5

Indemnification of Directors and Officers

§ 5.01	Indemnification Basics	5-2
	[1] The Concept of Indemnification	5-2
	[2] Historical Background	5-3
	[a] Common Law Theories	5-3
	[b] Statutory Development	5-3
	[3] Distinguishing Indemnification from Insurance	5-4
§ 5.02	Statutory Indemnification	5-5
	[1] Governing Law	5-5
	[a] State of Incorporation	5-5
	[b] Impact of Mergers and Reorganizations	5-5
	[2] Scope of Coverage	5-6
	[a] Who May Claim Protection	5-6
	[i] Directors, Officers, Employees, and Agents	5-6
	[ii] Directors, Officers, Employees and Agents of Affiliated Entities	5-9
	[b] What Matters Trigger Coverage as an “Action, Suit or Proceeding”	5-10
	[c] What Expenses Are Covered	5-11
	[3] Advancement of Costs	5-15
	[4] Types of Indemnification	5-23
	[a] Mandatory Indemnification	5-23
	[b] Permissive Indemnification	5-26
	[i] Third Party Actions	5-27
	[ii] Derivative Actions or Actions by the Corporation	5-28
	[5] Requirements for Obtaining Relief	5-29
	[a] Success on the Merits or Otherwise	5-29

TABLE OF CONTENTS

xiii

§ 5.03 [b] Good Faith 5-32

[6] Nonexclusivity 5-33

[7] Authorization for Insurance Coverage 5-34

[8] Fee Shifting 5-35

Corporate Indemnification 5-36

[1] Statutory Authorization for Charter
and Bylaw Provisions 5-36

[2] Shareholder Approval 5-36

[3] Charter and Bylaw Indemnification
Provisions. 5-36

[a] Charter and Bylaw Provisions
Generally 5-36

[b] Scope of Coverage. 5-38

[c] Other Provisions. 5-38

[4] Contractual Indemnification. 5-38.1

[a] Advantages 5-38.1

[b] Enforceability 5-38.1

[c] Typical Provisions 5-39

[d] Outside Entity Context. 5-39

§ 5.04 Public Policy Limits on Indemnification. 5-40

[1] General Public Policy 5-40

[2] Officials of Depository Institutions. 5-40

[3] Federal Securities Laws. 5-42

CHAPTER 6

**Overview of Directors and Officers
Liability Insurance**

§ 6.01 An Introduction to D&O Liability
Insurance 6-2

§ 6.02 Applying for the D&O Policy 6-4

[1] The Application and the “Warranty
Letter” 6-4

[2] Innocent Insureds 6-9

[3] Rescission. 6-14

§ 6.03 Components of a D&O Liability Policy 6-19

[1] Declarations 6-19

[a] Claims Made vs. Occurrence. 6-19

[b] Named Corporation 6-20

[c] Per Claim and Aggregate Limits 6-20

[d] Retentions and Deductibles 6-21

[e] Policy Period 6-24

[f] Retroactive Date. 6-24

DIRECTORS AND OFFICERS LIABILITY

	[2]	Insuring Agreements	6-24
		[a] Direct Coverage of Directors and Officers	6-24
		[b] Corporate Reimbursement Coverage.	6-30
		[c] Entity Coverage	6-33
		[d] Defense Coverage.	6-34
		[e] Specialized D&O Policies	6-35
	[3]	Exclusions.	6-35
	[4]	Definitions	6-36
		[a] Claim.	6-36
		[b] Loss.	6-42.1
		[c] Wrongful Act	6-50.1
	[5]	Conditions.	6-55
		[a] Notice of Claim/Circumstances. . .	6-55
		[b] Alternative Dispute Resolution . . .	6-63
		[c] Choice of Law	6-64
		[d] Consent to Settlement/Defense . . .	6-66
		[e] Extended Reporting Period	6-68
§ 6.04		Allocation	6-69
	[1]	Covered and Uncovered Claims	6-70
	[2]	Insured and Uninsured Capacity	6-72
	[3]	Covered and Uncovered Parties	6-74
		[a] Relative Exposure Rule	6-76
		[b] Larger Settlement Rule	6-77
	[4]	Policy Provisions Governing Allocation.	6-81
	[5]	Insured vs. Insured Exclusion.	6-83
§ 6.05		Advising Corporate Boards on Directors and Officers Insurance	6-84
	[1]	The Board Meeting	6-84
	[2]	Bankruptcy Concerns	6-85
	[3]	Rescission.	6-85
§ 6.06		D&O Insurance Audits.	6-87
	[1]	Why the D&O Insurance Audit?.	6-87
	[2]	Staffing Considerations	6-87
	[3]	Major Concerns in Performing the D&O Insurance Audit	6-88
		[a] The Deliberate Fraud Exclusion. . .	6-88
		[b] Severability.	6-89
		[c] Insolvency.	6-89

CHAPTER 7

Rules of Policy Interpretation and Construction

§ 7.01	Contract Interpretation Generally	7-1
§ 7.02	Insurance Policy Interpretation	7-6
	[1] General Rules of Interpretation	7-6
	[2] <i>Contra Proferentem</i> Doctrine	7-8
	[3] <i>Contra Proferentem</i> and the Sophisticated Policyholder	7-12
	[4] Coverage Grants vs. Exclusions	7-14
§ 7.03	The Parol Evidence Rule	7-16
§ 7.04	Determining Ambiguity	7-19
§ 7.05	Ambiguity and the Parol Evidence Rule	7-22
§ 7.06	Reasonable Expectations	7-27

CHAPTER 8

Exclusions in D&O Policies

§ 8.01	Introduction	8-2
§ 8.02	Insured vs. Insured/Entity vs. Insured Exclusion	8-4
	[1] General Provisions	8-4
	[2] Common Exceptions	8-9
	[3] Application to Governmental and Regulatory Action	8-10
	[4] Application to Bankruptcy and Insolvency Situations	8-15
	[5] Application to Whistleblowers	8-18
	[6] Application to Assignees	8-18
§ 8.03	Prior Acts Exclusion	8-19
§ 8.04	Dishonest, Fraudulent, and Criminal Acts Exclusion	8-23
§ 8.05	Employment-Related Activities Exclusion	8-32
§ 8.06	Outside Directorship Exclusion	8-35
§ 8.07	Bodily Injury, Property Damage, Advertising Injury, and Personal Injury Exclusion	8-38
§ 8.08	Prior Notice and Prior Knowledge Exclusions	8-43
	[1] Prior Notice Exclusion	8-43
	[2] Prior Knowledge Exclusion	8-46
§ 8.09	Prior and Pending Exclusion	8-48
§ 8.10	Regulatory Exclusion	8-53

DIRECTORS AND OFFICERS LIABILITY

§ 8.11	ERISA Exclusion	8-57
§ 8.12	RICO Exclusion	8-60.1
§ 8.13	Insurance Not Maintained Exclusion	8-61
§ 8.14	Personal Profit or Advantage Exclusion	8-62
§ 8.15	Return of Remuneration Exclusion	8-68
§ 8.16	Securities Exclusions, Including the “Bump Up” Exclusion	8-70
§ 8.17	Short-Swing Profit Exclusion	8-75
§ 8.18	Subsidiary Officers or Directors Exclusion	8-76
§ 8.19	Takeover Exclusion	8-77
§ 8.20	Bribes, Political Payments, and Gratuities Exclusion	8-80
§ 8.21	Pollution and Related Exclusions	8-81
	[1] Claims “arising out of” Pollution or Other Contamination	8-81
	[2] Climate Change Claims	8-84
§ 8.22	Breach of Contract Exclusion	8-90
§ 8.23	Professional Services Exclusion	8-93
§ 8.24	Money Laundering Exclusion	8-98
§ 8.25	Intellectual Property Exclusion	8-99
§ 8.26	Major Shareholder/Ownership Percentage Exclusion	8-100
§ 8.27	Severability Issues	8-101
§ 8.28	Exclusions and the Duty to Defend	8-106

CHAPTER 9**Claims Submission and Handling
Under D&O Policies**

§ 9.01	Notice of Claim	9-2
§ 9.02	Cooperation	9-8
§ 9.03	Insurer’s Duty to Investigate	9-12
§ 9.04	Insurer’s Duty to Pay or Advance Defense Costs	9-13
§ 9.05	Control of the Defense	9-14.7
	[1] Choice of Counsel	9-14.7
	[2] Separate Counsel	9-15
	[3] Litigation Guidelines	9-16
§ 9.06	Insurer’s Reservation of Rights	9-24
	[1] Waiver or Estoppel	9-24
	[2] Mend the Hold Doctrine	9-25

TABLE OF CONTENTS

xvii

§ 9.07 Bad Faith 9-31

[1] The Implied Covenant of Good Faith and Fair Dealing 9-31

[2] Bad Faith Breach of the Duty to Pay Defense Costs 9-34

[3] Bad Faith Breach of the Duty to Not Unreasonably Withhold Consent to Settlement of a Third-Party Action 9-36

[4] Bad Faith Conduct that May Prejudice a Policyholder’s Defense of an Underlying Action 9-38

[5] Bad Faith Litigation Practices 9-39

[6] Discoverability of the Claims File 9-39

§ 9.08 Damages Available in a Bad Faith Action 9-42

[1] Excess Judgments 9-42

[2] Punitive Damages 9-43

[3] Consequential Damages 9-45

[4] Damages for Mental Suffering 9-45

[5] Attorneys’ Fees 9-46

§ 9.09 Statutory Claims 9-48

[1] The Model Unfair Claims Settlement Practices Act 9-48

[2] Statutory Bad Faith Claims and Penalties 9-51

§ 9.10 Assignment of Coverage Claims 9-54

CHAPTER 10

Litigation and Settlement Considerations

§ 10.01 Choice of Forum 10-2

[1] Venue 10-2

[2] Doctrine of *Forum Non Conveniens* 10-4

§ 10.02 Justiciability Issues 10-8

§ 10.03 Arbitration Requirements 10-14

§ 10.04 Discovery 10-17

[1] Areas of Discovery 10-19

[a] Drafting History of the Policy 10-19

[b] Reinsurance Information 10-20

[c] Reserve Information 10-23

[d] Claims Handling and Underwriting Manuals and Guidelines 10-24

DIRECTORS AND OFFICERS LIABILITY

	[e] Advertising and Marketing Materials.....	10-25
	[2] Privilege Issues.....	10-26
§ 10.05	Trial of the Directors and Officers Coverage Case	10-30
	[1] Introduction	10-30
	[2] Judge vs. Jury Issues	10-30
	[a] Meaning of the Policy.....	10-30
	[b] Application of Policy Terms to Facts.....	10-33
	[3] Evidentiary Issues: “The Case Within a Case”.....	10-34
§ 10.06	Issues Arising Out of Settlements and Settlement Agreements.....	10-36
	[1] Exhaustion of Underlying Coverage....	10-36
	[2] Priority of Coverage Among Directors and Officers and Corporation	10-40
	[3] Consent to Settlement	10-41
	[4] Settling and Non-Settling Insureds	10-43
§ 10.07	D&O Policy Proceeds in Bankruptcy Proceedings.....	10-45
	[1] Bankruptcy’s Impact on Directors and Officers	10-45
	[2] Case Law on the Ownership of D&O Policy Proceeds in Bankruptcy.....	10-47
	[3] The Impact of Entity Coverage.....	10-50
	[4] Priority Provisions and Other Solutions.....	10-52
§ 10.08	D&O Insurance and Securities Litigation: Some Practical Concerns	10-55
	[1] Appointing a Conservator	10-56
	[2] Analyzing the Coverage	10-56
	[3] Avoiding Statements and Conduct Harmful to Coverage.....	10-58
	[4] Softening the Insurers’ Negotiation Position.....	10-60
	[5] Crafting the Settlement	10-61
INDEX	I-1