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Column

D&O: managers have to bear costs of defense

The reputation of the D&O-insurance has recently suffered due to the criticism of the settlement practice of some insurers. Subject of the discussion was the promise of indemnification of managers from liability claims. Recently, some insurers argue with insured managers about the amount of defense costs – and make them bear extensive lawyers' fees.

The refusal of some D&O-insurers to pay costs of defense proceeds as follows: At first, the insurer criticizes the inappropriate amount of hourly rates charged by defense lawyers and therefore denies coverage or payment of lawyers' fees. Today, specialists in boutiques and major law firms demand up to 700 Euros net per hour. Some D&O-insurers regard this generally as inappropriate, since other lawyers are cheaper. The quality of the lawyers plays a minor role in this argumentation. The free choice of lawyer seems to be no longer of importance.

If the manager and his specialized lawyer get involved in the game, the D&O-insurer will in a next step refuse payment of fees due to an inappropriate total amount of the claim, the number of hours spent on the case or simply because the work description of the lawyers does not appear reasonable to the insurer. For this reason, it recently happened that top managers had to bear six digit lawyers' fees and initiate legal disputes about the costs of defense.

Even managers who formerly earned high salaries get into liquidity problems – and the insurer is well aware of this. At the same time, defense lawyers are under pressure because they inevitably carry the coverage dispute between insurer and manager into the

mandate. By this, the settlement practice in the D&O-insurance reached an unpleasant new quality. It may endanger the relationship between client and defense lawyer due to incriminations by some D&O-insurers. It is irrelevant that this behavior may be contra-productive for the D&O-insurer with regard to the effectiveness of the defense. They refer to the lawyer's obligations.

Though the insurer's payment obligation comprises the reimbursement of appropriate lawyer's fees, some insurers do not perform any longer. Words such as "appropriate" are subject to assessment and therefore offer a surface for attacks.

The new dimension of settlement problems can also be seen in the managers' purchasing behavior. The legal expenses insurance which covers costs for the assertion of coverage claims against the own D&O-insurer, was formerly be smiled at. Today, managers insist on such legal expenses insurance. In addition, individual managers buy legal expenses insurance for themselves and at their own expenses in order to cover costs of defense in case of (at least partial) denial of coverage as it will soon be the usual case. The D&O-insurance itself will become a caricature and leaves more and more questions with the manager and the company.

Aforementioned insurers do not settle costs of defense any longer but instead pay for specialized lawyers themselves. These lawyers are instructed to give reason for the denial of coverage of defense costs.

The D&O-insurance's promise to pay for costs of defense has been reduced to absurdity if individual insurers refer to the so-called collaborative defense to justify the reduction of defense lawyers' fees of individual managers. Collaborative defense means: the D&O-insurer joins the liability proceeding with his own lawyers and „coordinates" the claims of several managers from a single source.

An individual defense of the manager who obviously will not necessarily have the same interests as the insurer and other executives, is according to this argumentation no longer required. Fees of the defense lawyers of the manager will therefore be reduced or charged to the manager. The individual defense lawyer then did not have to perform all work, as the insurer argues.

It remains a mystery which part of work would not have to be performed by the defense lawyer. Formerly it was the insurer's very own task to perform the coordination in

the background. The soundly positioned insurance company will still succeed in doing so.

This settlement practice of some – not all – D&O-insurers undermines the expectations connected to D&O-policies further and harms the reputation of reasonably settling insurers. Some D&O-insurers become more and more an opponent of policy holders and managers.

For this reason the meticulous contract drafting regarding the D&O-insurers promise to pay for costs of defense is now indispensable. Today it is almost a necessity to buy additional legal expenses coverage for the protection of individual managers against their own D&O-insurers. The manager is not able to differentiate between a solidly settling D&O-insurer and a future "opponent".

It would be desirable to stop such development, not only in order to ensure (of course) the payment of lawyers' fees, but also to create certainty for managers. Times seem to have passed when the parties involved in a D&O-insurance contract worked together.

Dr. Mark Wilhelm, LL.M.
Lawyer
Master of Insurance Law
Specialist Solicitor for Insurance Law

Wilhelm Rechtsanwälte
Partnerschaft von Rechtsanwälten mbB
Reichsstraße 43
40217 Düsseldorf

Telephone: + 49 (0)211 687746 - 12
Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de
mark.wilhelm@wilhelm-rae.de