

Ensuring continuity of coverage in D&O and EPLI policies

By WAYNE E. BERNSTEIN, CIC
Executive Perils Inc. / Los Angeles, California

THE TERM “continuity” is frequently used when discussing directors and officers liability insurance, employment practices liability insurance and other claims-made products. Yet, the concept is often confusing to many insurance professionals. The dictionary defines continuity as “uninterrupted succession or flow.” That accurately describes the purpose of continuity in insurance policies. The objective is to see that the original coverage is maintained, without gaps, as insurance is renewed from year to year.

Three matters must be addressed when trying to ensure continuity. One, pertaining mainly to D&O policies, is the warranty of the initial application. Another is the policy’s pending or prior litigation exclusion date, and the third is the prior-acts exclusion and retroactive date.

The chain of continuity begins when coverage is first written for an insured. If coverage renews with the incumbent insurer, continuity is maintained at the anniversary of the first renewal and thereafter, as long as coverage is maintained with the same insurer. However, if the insured opts to renew with another insurer, continuity may or may not be maintained, depending on the new insurer writing the coverage.

Ideally, to maintain “full” continu-

ity, the insurer issuing the renewal policy should allow the use of a short-form (renewal) application and backdate the pending or prior litigation date to initial date coverage was written. (Be careful. Not all renewal appli-

Warranty statements, pending or prior litigation dates, and prior-acts coverage must be considered when changing carriers.

cations provide continuity.) The insurer also should provide full prior-acts coverage. Any departure from this process could adversely affect an insured’s coverage. Let’s examine each step in more detail.

When a D&O or EPL policy is initially written, the insured completes a

long-form application, which includes warranty questions. A warranty question reads something like this: “Is any person or entity proposed for this insurance aware of any fact, circumstance or situation which may result in a claim against the organization or any of its directors, officers or employees?”

Once the corporation’s chairman, CEO or president signs the completed application, it becomes part of the policy. The insurer materially relies on the warranties in the application to issue coverage, and breach of the warranties can affect the outcome of a claim settlement. Each insurer uses its own long-form application, and the contents of applications vary widely among carriers.

When coverage is renewed with the incumbent insurer, the insured completes a “short form,” or renewal application. If for some reason a long form must be used for the renewal, the incumbent insurer often allows the insured to strike the warranty questions in it. That way, continuous coverage from the original policy’s inception date cannot be jeopardized by knowledge an insurer contends the insured later acquired but failed to disclose when the insured signed a subsequent set of warranty statements.

If coverage is renewed with an insurer other than the incumbent, a bro-

ker should negotiate the use of a renewal application or a long-form application without the warranty questions. This is not always acceptable to an underwriter. If a new long-form application with warranty questions is the only option, then continuity is broken.

The “severability” of the insurance application also needs to be considered when changing insurance companies. Severability will protect those insureds who do not sign the application if a subsequent claim leads a carrier to conclude the warranty questions were not answered accurately. This is an important factor in the determination of whether the policy will protect “innocent” directors, officers and employees. Some policies provide full severability; others do not. An examination of the actual policy is recommended, since severability is not always addressed in the application. Provisions differ too. Sometimes coverage is voided even for innocent insureds if persons signing the application knowingly make false or misleading statements.

Pending or prior litigation date

Insurance brokers often confuse the pending or prior litigation exclusion with the prior-acts exclusion. A typical pending or prior litigation exclusion bars coverage for “any prior or pending litigation that is known, including any facts, incidents or circumstances the insured had knowledge of with respect to any ‘claims’ or ‘wrongful acts,’ including administrative or regulatory proceedings, prior to the time the policy was written and/or of which any notices were given to any prior insurers.”

It’s important to check a policy’s definitions of claims and wrongful acts. A claim may or may not include a non-monetary demand, as well as a monetary demand, against the named insured. A claim may include written demands in one policy, or both oral and written in another. The definition usually includes administrative or regulatory proceedings, such as matters involving the Equal Employment Opportunity Commission or the Securities and Exchange Commission. If a complaint is filed against an insured with the EEOC, the insured may not

realize the insurer considers this a “claim.” More to the point, if the insurer failed to report the complaint to the incumbent insurer, the carrier might not respond to a lawsuit that arises after its policy expires. Meanwhile, the new insurer could deem this to be “pending or prior litigation” and also deny coverage for any subsequent litigation.

The term “wrongful act” also may be given different definitions in different policies. A D&O wrongful act may mean any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duties by a corporation’s directors or officers of the corporation. The definition may or may not include “wrongful employment acts.” Such an act may be defined as any actual or alleged act of discrimination, harassment, retaliation, wrongful discipline, employment related misrepresentation or wrongful termination committed by the insured entity’s directors, officers or employees.

The reason for the pending and prior litigation exclusion date is to ensure that a new insurer does not have to pay a claim arising from active or pending litigation that an insured knew about before the effective date of the new coverage. After all, the insured should have notified the previous insurer of all such litigation or incidents that could lead to claims.

Ideally, to maintain coverage continuity, a new insurer should agree to use the inception date of the insured’s initial D&O or EPL policy as the new policy’s pending or prior litigation exclusion date. In practice, however, the great majority of insurers use the date their policies take effect. Depending on the state of the insurance market, a new insurer may agree to keep the expiring policy’s pending or prior litigation date, if the insured provides copies of all notices or claims given to previous insurers. Additional underwriting criteria may have to be met as well.

Retroactive date

A common misconception is that D&O and EPLI policies have prior-acts exclusions. In reality, the policies themselves afford full prior-acts coverage for wrongful acts, including em-

ployment-related acts, as long as the insured had no knowledge of them. Some insurers restrict this coverage, however, by adding prior-acts exclusions and accompanying retroactive dates via endorsement. For EPLI policies, the exclusion most often is added when there has been no prior coverage. D&O policies may have prior-acts exclusions, as well. For insureds that have been involved in mergers and acquisitions, the insurer may want to restrict coverage for past wrongful acts of an acquired entity.

If the previous policy provided full prior-acts coverage, and the new policy has a prior-acts exclusion, with the retroactive date set at the new policy’s inception date, continuity is broken. Of course if the new insurer uses the same retroactive date as the previous policy, then continuity remains intact. Sometimes a new insurance company will provide full prior-acts coverage (i.e., not use a prior-acts exclusion endorsement.) In those cases, however, the carrier likely will require a new long-form application to be completed, which of course also breaks continuity.

Weighing the implications

As we’ve seen, coverage continuity can be broken in several ways. Whether a break is good or bad depends on one’s perspective. The reality is that insureds most likely will not be able to maintain full continuity of coverage when moving from one insurer to another. Most often, a new long-form application (with warranty questions) will have to be completed, or a previous policy’s pending or prior litigation date will not be honored. The worst-case scenario, however, is having a new insurer impose a prior-acts exclusion. An insured should resist this outcome unless no other options are available.

Because of threats to coverage continuity, it is usually desirable for an insured to maintain coverage with the incumbent insurance company. Unfortunately, insureds often give a lot of weight to price and may not attach much importance to continuity. A good insurance broker, however, will make sure the client fully understands the implications of a loss of continuity.

