Taking the necessary steps

How to protect yourself against D&O lawsuit exposure

There are many pitfalls that can trip up a corporation, leaving its leaders open to directors and officers liability lawsuits, which can be costly and cause image problems.

In addition, because of the possibility of lawsuits, many potential directors and officers will not join a company that does not protect them from these claims, making it difficult to recruit the talented managers needed for success.

For these reasons and others, it is essential that corporations take the necessary steps to protect themselves and their directors and officers from potential claims.

"By taking appropriate action, corporations can significantly reduce the risk and impact of D&O claims, thus reducing the potential for costly and disruptive litigation," says Jeffery S. Matis, executive partner at Secrest Wardle.

Smart Business spoke with Matis about what actions business leaders can take to protect their corporations from D&O claims.

What are D&O claims, and how do they impact a corporation?

A D&O claim is generally brought by stockholders, employees or clients against a corporation and its directors or officers, individually, for acts performed by these individuals in their capacity with the corporation. The claim is normally based upon theories grounded in breach of fiduciary duties, conflict of interest, insider trading and employment, among others.

Directors and officers of corporations are fiduciaries who owe a strict duty of good faith to the corporation. As such, corporate directors and officers are required to discharge their duties with the degree of diligence, care and skill that an ordinary, prudent person would exercise under similar circumstances and in a manner reasonably believed to be in the best interests of the corporation.

The negative impact on a corporation of a D&O claim can be enormous. Beyond the potential for liability and the expenditure of attorney fees and costs, a corporation facing a D&O claim will likely be forced to direct corporate attention and resources in a generally nonproductive direction. Also, such claims can potentially become high-profile, media-based claims that pose a significant distraction for a corporation.

Jeffery S. Matis
Executive partner
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How can having D&O insurance reduce the impact of such claims?

By purchasing D&O insurance, a corporation can effectively limit its exposure to D&O claims in many instances. Further, as directors and officers can be held personally liable for their actions, many of them will require that they be individually protected by D&O insurance.

In fact, a corporation's ability to obtain qualified directors and officers may be negatively impacted by the corporation failing to purchase D&O insurance.

It is also noteworthy that while claims for fraud or intentional or criminal conduct may not be covered, generally D&O claims arising from the actions of directors and officers in their capacities with the corporation will be covered under the standard D&O insurance policy. It is highly recommended that corporations thoroughly review their D&O insurance policies to make sure that the desired insurance coverage has been obtained.

What can trigger a D&O claim?

An area that gives rise to many D&O claims is that of a conflict of interest. One example of this is when a director or officer supports corporate action involving another entity in which the director or officer has an interest.

In order to minimize exposure to D&O claims in this regard, directors or officers should disclose the existence of any potential conflicts of interest and recuse themselves from any corporate action involving entities in which they have an interest. The scope of the recusal should involve abstaining from any votes and not participating in any discussion related to the conflict of interest.

What defenses can a corporation raise in a D&O lawsuit?

Under Michigan law, a D&O lawsuit must generally be filed within three years after the cause of action has accrued, or within two years after the time when the cause of action is discovered or should reasonably have been discovered, whichever occurs first. A lawsuit not filed within this time frame should be met with a strong motion to dismiss on the basis of the statute of limitations.

In addition, a director or officer can generally avoid liability for the breach of a duty of care by showing a good-faith reliance upon financial information, reports or advice of a corporate accountant, attorney or other professionals.

Further, directors and officers are generally immune from liability for the breach of a duty of care under the Business Judgment Rule absent the existence of bad faith or fraud.

Specifically, the Business Judgment Rule creates a presumption that, in making a business decision, the directors or officers of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the corporation.

As such, a corporation can minimize its exposure to D&O claims by thoroughly documenting advice provided by accountants, attorneys or other professionals that is related to action taken by directors or officers.

Independent of this advice, a corporation can minimize its exposure under the Business Judgment Rule if it can be established that decisions are reasonably supported, documented, made in good faith and with due care. <<

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