

YOU ARE A DIRECTOR, OFFICER OR MANAGER AND JUST GOT SUED, NOW WHAT?

You served as a director and/or officer of a corporation and have just been named as a target of an investigation and in a civil lawsuit as a defendant. Can the corporation help you with hiring an attorney, paying counsel and defending your position? Or maybe you are a manager of an LLC under the same circumstances. What protections can the company give you with an insurance policy, corporate governance documents or other Arizona statutes to provide indemnification.

First, does the company have an insurance policy that will cover you for any settlement or judgment that may be entered against you (Indemnity) or pay the legal fees and expenses to defend you (Defense Costs). If a policy exists, is there coverage or has the insurance company reserved their rights to pay Indemnity or Defense Costs?

A director and officer liability policy (D&O policy) can provide coverage to you for covered acts taken by you during the course and scope of your duties as a director and officer. However beware, that if you were not acting by fulfilling your duties to the corporation under the facts- alleged or legal claims then the insurance carrier, is not liable to defend you or pay indemnity. Usually D&O policies are depleting policies. This means that the amount of coverage available is reduced by the costs the insurance company pays for attorneys to defend the claim. While the insurance carrier in typical insurance defense policies have the right to select counsel, the depleting nature of D&O policies does permit on occasion the insured party to select its own counsel at whatever fees that lawyer may charge to be paid under the policy. If you do not get to select your own counsel, then the insured party may have the ability to contribute greatly to the selection of counsel.

Generally there is no coverage for intentional acts of the directors and officers. Nor is there insurance coverage under other types of insurance policies for such intentional acts. Depending upon the claims that are actually brought against you as a director, officer or manager there might also be available other insurance coverage to provide Defense Costs and Indemnity. For example, there might be a Comprehensive General Liability (CGL) policy, an Employers Practice Policy (employment), or a business owner's policy (BOP) which might provide Defense Costs and Indemnity. Don't forget to check your homeowner's policy and any umbrella coverage available.. Ask your personal insurance agent to turn in any claims you have against any policy and carrier.

After examining the issue of insurance coverage turn next to the corporate governance documents. The Articles of Incorporation, Bylaws, and any Shareholder Agreement may provide contract provisions requiring the

Company to pay Defense Costs and Indemnity. for the director/officer. The Articles of Organization of an LLC or more likely the Operating Agreement is a source of agreed upon indemnification for managers. These Bylaws and Shareholder Agreement for a corporation and the Operating Agreement for an LLC represent contracts between the directors and officers and their respective companies for Indemnity and Defense Costs. Most have allowances for the company to advance Defense Costs and any settlement or judgment. . But these contract provisions usually have standards that must be met before any director, officer, or manager is entitled to be paid their expenses or any Indemnity. These standards may require the director, officer or manager to act in good faith, in the best interests of the company or at least not opposed to the best interests of the company in order to receive Defense Costs as an advance or Indemnity. The standard may require the person to have not engaged in willful misconduct or gross negligence. Other provisions may require one to act as one partner is required to act toward all partners in a partnership. Not all these standards are well described or enunciated in law.

Arizona also has statutes that allow a director and officer to receive Defense Costs and Indemnity. A director or officer is entitled to indemnification if that person is found not liable in a legal proceeding and/or that person met the standard of conduct set forth in the Arizona statutes. The director and officer standard for conduct requires the person during the course and scope of his or her agency to the company to act in good faith, in a manner the director or officer reasonably believed to be in the best interests of the company, and as a reasonable director or officer would do under similar circumstances. If the director or officer is adjudged liable in the legal proceeding then they must ask the majority of the board of directors who were not involved in the litigation for indemnification. If that fails then a person may try to get the company to obtain an independent legal opinion or proceed to court to obtain indemnification.

Arizona statutes do allow for directors and officers to obtain an advance of the Defense Costs if they meet certain requirements. The requirements include providing a written agreement or undertaking to pay back any amount of funds or payments by the company for Defense Costs if it is later determined they are not entitled to them and to swear they met the statutory standard of conduct for directors or officers.

The next area that needs to be examined for a director, officer or manager indemnification is common law indemnity. Common law indemnity was established to allow one who is possibly at fault for causing damages to recover their Defense Costs and Indemnity from the person who was actively at fault in causing the damages. These doctrines arose when Arizona law recognized that all responsible parties can be jointly and several liable. This means that any of those parties may have to pay the entire judgment rendered against them.. However, Arizona law changed to a comparative fault system requiring the person found at fault to pay only their share of the damages based on the

amount of fault contributed to cause the damage. Now despite the fact that one party might not be responsible for paying the entire judgment, they may still apply to have another pay reasonable costs and expenses and any judgment that had to be paid as a result of their actions. It is unlikely to see a party actively causing fault to recover from a party who was passively at fault.

One can also ask another who was actively at fault for causing damages to contribute to the reasonable costs and expenses incurred in defending their position. This doctrine of contribution is alive and well and believed to part of the fault of scheme in Arizona.

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