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Initial Receiver Assessment of Director and Officer Insurance Policies

By John G. Younger, MD and Hank Clement

The Practitioner's Corner is a regular feature where NAFER members can contribute their personal perspectives on issues facing receivers.

Director and Officer (D&O) insurance is partly, but not exclusively, designed to protect company leaders from personal financial exposure arising from legal claims related to their corporate decisions and actions. These policies typically cover both defense costs and financial liabilities from settlements or judgments, offering a vital layer of security to leaders making difficult decisions in good faith to fulfill their fiduciary responsibilities.

While many directors and officers view D&O insurance as a straightforward benefit provided by the company, the reality is more complex. When the interests of the company and its leadership are aligned, the policy functions similarly to professional liability coverage. However, when those interests diverge—such as in cases of alleged misconduct or insolvency—the policy can serve broader purposes, including recovery of losses stemming from fiduciary breaches or other wrongful acts. For a receiver, this means a D&O policy may provide – sometimes simultaneously – protection *for* a company's directors and officers and protection *from* them.

Despite their significance, D&O policies are frequently misunderstood, even by those they are meant to protect. Terms and conditions vary widely, and coverage can be applied in different ways, especially when a company enters financial distress. For receivers, this lack of clarity can be consequential: although policy limits may appear substantial, ongoing legal costs may already be depleting available coverage by the time a court-appointed team assumes control.

A thorough understanding of D&O policy mechanics is therefore essential. The interplay between D&O coverage, director and officer liability, and receiver-

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ship authority creates a complex legal landscape—one where policies simultaneously protect individual directors while representing potential recoverable assets for the estate. Fully exploring this terrain, including litigation strategy and settlement mechanics, is beyond our scope here. Instead, we provide a practical framework for the initial evaluation of D&O policies in receivership: identifying what coverage exists, who controls it, and how the appointment of a receiver affects access. We outline key questions that receivership teams should address immediately upon assuming control and recommend initial steps to preserve and maximize coverage options.

A Representative Case

A privately held, venture-backed medical device company launched a novel but high-cost treatment for chronic headache following FDA clearance and a reimbursement green light from the Center for Medicare and Medicaid Services and private insurers. The company began enrolling patients in a new 'post-market' clinical study to further prove their technology's superiority over competitors.

To finance its commercial expansion, the company initiated the sale of additional equity and pursued a new secured loan facility. While fundraising and lending discussions commenced, an interim analysis of the clinical study by an independent data safety and monitoring panel – presented confidentially to the company's scientific team and CEO – indicated the new treatment offered no benefit over standard care and that the study was very unlikely to support use of the company's product. These new facts were not shared with the Board, investors, or the new lender. The equity sale and loan agreements were finalized while the unfavorable interim clinical data remained undisclosed.

Soon after, the CEO sought, and received, Board approval to sell $2.5 million of her equity stake through a secondary market platform.

Following the public release of the negative clinical study results, the Centers for Medicare and Medicaid Services issued a non-coverage decision, cutting off reimbursement from most payers. Revenue collapsed, covenant breaches followed, and a board observer raised concerns about the CEO's potential misrepresentation of the company's condition when requesting permission to sell a portion of her shares. The final straw came when a member of the scientific team and a company accountant jointly submitted a claim to the SEC's Tips, Complaints, and Referrals website asserting that the negative clinical trial results had been suppressed during financing discussions with investors and lenders and that the CEO had liquidated part of her ownership stake based on material non-public information.

Within weeks, the SEC filed an enforcement action in federal district court and secured the appointment of a receiver. Once on site, that team immediately turned to the company's Directors and Officers (D&O) coverage: how much remained, what terms governed its use, and whether it could support recovery of losses stemming from the CEO's purported misconduct.

Coverage Structure: The Three Sides of D&O Insurance

D&O insurance policies typically address two categories of financial exposure: (1) legal defense costs, and (2) liabilities from settlements or judgments. These expenses usually draw from a shared policy limit, meaning that funds used for one category reduce the amount available for the other. This creates a zero-sum dynamic among stakeholders—directors and officers seek maximum coverage for their defense, claimants aim to preserve those same funds for resolution, and receivers may view the policy as a corporate asset to benefit the estate.

To manage these competing interests, D&O policies are structured around three distinct coverage mechanisms, commonly referred to as "Sides":

Side A – Non-Indemnifiable Loss. This coverage applies when the company cannot or chooses not to indemnify its directors and officers. Common triggers include insolvency, court order, or allegations of misconduct. Another important trigger for Side A coverage is financial *impairment,* rather the actual insolvency. Some policies may define a company as financially impaired if its leadership is no longer able to independently indemnify named insureds, such as in bankruptcy or receivership, regardless of having the financial wherewithal to do so. Side A thus ensures personal protection for directors and officers even when corporate indemnification is unavailable. Under Side A, the insurer pays defense costs directly to the individuals, bypassing the company. Law firms defending insured parties typically submit invoices directly to the carrier, eroding a policy's aggregate limit and reducing the asset remaining for the estate or other stakeholders with claims on the coverage.

Side B – Indemnification Reimbursement. Side B is the most frequently activated, although for reasons described above may be unavailable, or halted, once a company files for bankruptcy or is placed in receivership. Under Side B, the insurance carrier reimburses company expenses incurred from indemnifying its directors and officers for legal expenses. This coverage is available as long as the company remains solvent or otherwise unimpaired and as long as indemnification is permitted under the company's bylaws or contractual agreements with named insureds. In receivership, Side B coverage is only triggered if the estate opts to provide indemnification. Given limited resources and potential allegations of breach or misconduct, a receiver may adopt a cautious "wait and see" approach—declining to indemnify until obligations are clarified, allegations of misconduct are more clearly understood, and insurance recovery appears certain. A receiver also has the authority to halt or withdraw indemnification that was previously extended if it threatens estate assets or conflicts with statutory limits.

Side C – Entity Coverage. Side C provides direct coverage to the company itself. For public companies, this is typically limited to securities-related claims. However, for private companies, Side C is broader and may include coverage for mismanagement allegations, vendor disputes, and regulatory investigations. Without Side C, the company would be exposed even as its executives are defended. Like Sides A and B, Side C draws from the same overall policy limit, intensifying competition for available funds. In addition to D&O coverage, companies may also carry fidelity bond insurance, also known as crime insurance, that may be relevant if there has been alleged criminal theft of company funds. The presence, mechanics, and interactions of these policies should be clarified as part of the initial evaluation of the company's D&O coverage.

Evaluating D&O Policies at the Onset of Receivership: Key Questions and Considerations

Upon assuming control of a distressed company, a receiver must promptly secure and assess the status and structure of its D&O insurance policy. This evaluation should begin with a full retrieval of the policy and all endorsements, followed by a review of the following critical questions:

1. How Much Coverage Is Truly Available?

While the aggregate policy limit is important, many D&O policies impose a per-claim limit that governs the total payout for all losses—defense costs, settlements, and judgments—arising from a single claim. Insurers often invoke "related claims" provisions to consolidate multiple lawsuits, investigations, or demands into a single claim if they share a common nexus of circumstances. This bundling can significantly reduce available coverage across multiple matters. Beyond litigation, some policies may cover expenses related to regulatory hearings, crisis communications, or other special situations—so understanding the scope of covered costs is equally important.

Additionally, D&O policies may share limits with other lines of coverage, such as employment practices liability or fiduciary liability. If these other claims have already drawn from the policy, the remaining coverage for directors and officers may be diminished.

2. Who Is Covered?

Coverage typically extends to duly elected or appointed directors and officers, as defined in the company's bylaws. However, private company D&O policies often include broader definitions, sometimes covering all employees and potentially volunteers. Additionally, when prior to the naming of a receiver a chief restructuring officer or similar appointee was brought on board to manage the company, the D&O Policy coverage may need to be endorsed to include any court-appointed receiver, administrator, liquidator, or equivalent person as an Insured. To avoid disputes, any additional insured parties should be clearly documented in both the policy (via endorsements) and company records (via executed indemnification agreements).

3. Has the Policy Been Triggered, and What Remains?

If the company's distress predates the receiver's appointment, the D&O policy may already be active and partially depleted. Receivers should identify all claims or investigations formally noticed to the insurer, confirm the dates of first notice, and determine which coverage sides (A, B, or C) are currently engaged and for whom.

Reviewing the insurer's coverage position letters, reservation-of-rights notices, and related-claims determinations is essential to understanding how much coverage remains and which matters are eligible for funding. For triggered policies, receivers should request from carriers a current *loss run report* – listing all claims noticed to a policy, including reserves, payments made, and amounts outstanding. Where the estate is advancing costs under Side B coverage, the loss run should also be reconciled against legal invoices payable and policy reimbursements receivable to gain a full picture of the remaining policy limit.

4. How Will Payments Be Prioritized, and What Exclusions Apply?

Payment Allocation. One of the most important provisions in a D&O policy is the priority of payments clause. This provision determines the order in which claims are paid when multiple coverage sides—Side A, B, and C—are triggered simultaneously. Most policies prioritize Side A, ensuring that non-indemnifiable losses for individual directors and officers are paid first. For receivers, confirming the priority of payments is critical in situations where both the entity and its leaders face claims. The clause not only dictates whether the estate's claims will compete with defense costs, but also shapes how quickly the policy may erode and how much leverage the receiver has in negotiating allocations or settlements with the insurer and insured parties.

*Insured vs. Insured Exclusio*n. Most D&O policies contain an "Insured vs. Insured" exclusion, a carve-out that removes coverage for disputes between parties inside the company. The exclusion's original purpose was to prevent collusive lawsuits—cases where a company and its directors might align to trigger insurance proceeds as a means of monetizing the policy and infusing cash into the company.

In a receivership, however, this broad exclusion can unintentionally bar coverage for genuine estate claims against directors or officers. To address that risk, many policies include 'carve-backs' that restore coverage for claims brought by bankruptcy trustees, debtors-in-possession, court-appointed receivers, or creditors' committees. A receiver should promptly confirm whether these carve-backs exist and how they are worded. Without them, estate claims may be left uninsured, depriving creditors of one of the few remaining assets, and directors may also lose the protection they expect in a distress setting.

Conduct Exclusion. The conduct exclusion eliminates coverage for losses resulting from fraud, criminal acts, willful misconduct, or illegal personal gain. However, the scope and timing of this exclusion vary across policies. Ideally, the exclusion should only apply after a final, non-appealable adjudication of misconduct. This allows coverage to remain in place during investigations and litigation, preserving defense resources until wrongdoing is legally confirmed. Additionally, the policy should specify that the conduct of one insured individual is not imputed to others. This protects innocent directors and officers from losing coverage due to the actions of a single colleague.

Given the tangle of issues outlined in items 2-4 above, it is not surprising that insurance carriers in receivership proceedings often interplead the policy proceeds with the court for determination of coverage obligations. This may simplify an otherwise complex situation in which the carrier, the estate, and multiple insured parties have sharply divergent expectations about use of the policy.

5. What are the carrier's reporting requirements and have they been met to date?

D&O policies are written on a claims-made and reported basis. Coverage is only triggered when a claim is made and reported within the policy's specified timeframe through specified channels. A "claim" is typically defined as a written demand for monetary relief, but many policies extend this definition to include regulatory inquiries, investigations, or other formal proceedings.

Strict reporting requirements mean that delays in notifying a

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carrier—even if unintentional—can result in denial of coverage. It is imperative that all claims or potential claims are reported to the insurer as soon as possible and in full compliance with the policy's notice provisions. For a receiver, the immediate concern is whether reporting requirements have been satisfied for claims made before the receiver's appointment. If claims, threats, or investigations were not noticed properly before the appointment, coverage may already be lost.

6. What restrictions exist regarding the selection of defense counsel?

If defense counsel has not yet been engaged at the time of the receiver's appointment, the receiver should determine who has the right to select defense counsel under the policy. Some D&O policies grant the insurer the duty and right to appoint counsel, while others allow the insured party to choose their own legal representation. If the insured has a choice, the receiver should move early to coordinate—ensuring that any defense counsel selected does not undermine estate claims or trigger unnecessary erosion of policy limits. Pre-clearing acceptable firms with the insurer, before claims materialize, avoids last-minute disputes and protects the estate's ability to shape litigation strategy.

The case, revisited. Our example case raises several critical questions for the receiver to resolve. The overarching uncertainty lies in the value of the estate following a negative randomized clinical trial of its only product. Assessing the company's and the technology's value will require close analysis of the trial's design, conduct, and results—a process that will shape both the future scientific credibility of the company to its medical customers and the commercial outlook. While that assessment unfolds, the estate also faces disputes directly tied to the D&O policy.

First is the question of disclosure. If the CEO withheld interim negative trial results while pursuing new equity or a secured loan facility, creditors and investors may claim fraud or misrepresentation. The timing and content of communications will be dissected, as will case law related to the duty to disclose interim research data, and the carrier's position on D&O coverage will turn heavily on those details.

Second is governance. Failing to disclose interim results to the board and senior leadership is more than a disclosure lapse—it directly affects whether directors and officers will remain engaged in helping stabilize the company. Their continued cooperation is often contingent on assurance that the D&O policy will protect them from legal expense exposure.

Third, for the estate, the salvage value of the inventory and IP related to a clinically ineffective product may be deeply discounted or practically worthless. Unfortunately, in cases such as this the company may have greatly increased its inventory on the eve of commercial expansion only to find the residual value of those products less than the warehousing fees necessary to store them. Similarly, there may be little market for the company's core patents, rendering their value less than annual US and international patent maintenance fees. Thus, the D&O policy may be among the most valuable remaining assets. Priority-of-payments provisions, insured-vs-insured carve-backs, conduct exclusions, and claims-payment history will all determine whether that asset can be realized or whether it erodes in defense costs and coverage disputes. The receiver must therefore view the policy not as background insurance but as a contested financial instrument that could shape the ultimate recovery for creditors.

Ultimately, the value of D&O coverage depends not only on the policy but also on the people around it. Directors and officers who remain engaged—sharing information, assisting with notice obligations, and cooperating with the receiver—may be more willing to do so because the policy provides them security against personal legal expense. That protection helps keep experienced leadership and staff involved at a time when their knowledge is most needed to understand the complexities of the organization and to preserve value. Without confidence in coverage, the team may disengage, leaving the receiver with less information and weaker support.

Brokers with deep D&O expertise are also important, though their influence is largely front-loaded: they shape policy language, carrier selection, and notice practices at placement. Once a company enters receivership, their role shifts to providing institutional memory of how the policy is structured and what has been communicated to the carrier. While they cannot resolve disputes, their documentation and perspective help the receiver maximize what remains of the policy as a core estate asset.

For a receiver, D&O insurance can become one of the estate's most consequential assets, shaping recoveries and influencing whether key leaders remain engaged. Its value turns on details—the clarity of exclusions, the handling of notice, the order of payments—that decide whether coverage is preserved or lost to erosion.