Sports Litigation Alert

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D&O Coverage for Sports Business Claims Is Not a Slam Dunk

By Jerry Oshinsky and Vered Yakovee

Today's grim economy is not lost on the sports world. Officers and directors of teams, governing bodies, sponsors, and other business partners are making difficult decisions about where to invest the fewer dollars that are still in play. Events surrounding the 2009 NFL draft provide one example; at the time that Round One began on April 25, 2009, not even one sneaker deal was inked with a draft prospect. Another example is apparent in the lay-offs that the sports industry—as most industries—continues to experience. Results of lay-offs may include business judgment-based claims, claims of discrimination, and other potential claims against the organization and its directors and officers. Discrimination lawsuits arise in sports independent of the economy as well. The first part of 2009 already saw Zina Garrison sue the USTA for alleged racial discrimination when the Association replaced her as team captain for an event; Elgin Baylor sued the Los Angeles Clippers and the NBA for alleged racial discrimination when he resigned after 22 years of employment, and other, similar scenarios continue to surface in the sports world.

Jerry Oshinsky is a Partner and Vered Yakovee is Counsel in the Los Angeles office of Gilbert Oshinsky LLP. Vered also teaches sports law at the USC Gould School of Law.

Much has been written about these claims and the related liabilities. But one area of potential recovery for defendants in these cases receiving insufficient focus is directors and officers ("D&O") liability insurance coverage issued to teams, governing bodies, sponsors, and other business partners. Such insurance may be available to help defray costs associated with the claims described above on behalf of not only individual directors and officers, but also the organization itself under certain circumstances.

DIRECTORS AND OFFICERS LIABILITY INSURANCE

D&O insurance may be a path to recovery for attorneys' fees and potential liabilities for defendants. A typical D&O policy provides coverage for individual directors and officers as well as for the organization when it indemnifies those individuals. Some D&O policies also provide a third type of coverage—what is commonly referred to as "entity coverage" or "enterprise coverage." "Entity coverage" applies to claims against the entity itself—independent of the individuals—and can be particularly useful for employment-related claims including alleged discrimination.

Just a few of the many key issues to consider in order to preserve a claim for coverage include: (1) timing of a claim; (2) definition of a claim or loss; (3) fraud and dishonesty exclusions; (4) professional services exclusions.

1. TIMING OF A CLAIM: D&O policies are typically claims-made policies, requiring that a claim be made during the policy period against the director or officer, or against the corporation if the policy provides "entity" coverage. They may also require that notice be provided to the insurer during the policy period or extended reporting period. However, even if a formal claim is not made, notice of events or circumstances during the poli-

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cy period or extended reporting period often will suffice to preserve the coverage for an eventual claim. Insureds should carefully review their policies for "Notice/Claim Reporting Provisions," or other provisions governing notice of a claim to ensure that they comply with the terms governing their specific policy.

2. DEFINITION OF A CLAIM OR LOSS: A claim against the insured person or entity is required to trigger the insurers' obligations under a D&O policy. While a typical claim often is defined in a D&O policy very specifically, courts have found that a claim can include a broad assortment of events and circumstances. A typical definition in a D&O policy sets forth coverage for the following types of claims:

> 1. A written demand for monetary or non-monetary damages; 2. A civil proceeding commenced by the service of a complaint or similar pleading; 3. A criminal proceeding commenced by a return of an indictment; or 4. A formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document; against any insured person for a wrongful act, including any appeal therefrom.[1]

In addition to the specific definition above, a claim has also been held to include attorneys' fees incurred in responding to a governmental subpoena or investigation, and other demands or assertions that may result in the liability of the insured.

A typical policy defines "loss" as "any amount which the Insureds are legally obligated to pay for a claim or claims made against them for Wrongful Acts, and shall include . . . defense of legal actions, claims or proceedings."[2] Construing such policy language, courts have held that attorney's fees were "reasonably incurred in 'defense of ... claims' under the loss provision of the policy"[3] and as a result they were covered, and required to be advanced even before a determination of coverage.

When evaluating whether to notify its insurer for a claim or loss under a D&O policy, an insured should weigh two competing interests. In the first instance, claims or losses should be reported because if they are not, they will not be paid. However, if an insured reports every set of facts, events, and circumstances that may lead to a claim, the insurer might determine that the insured is a higher risk than anticipated, and may raise its premiums or refuse to renew its policy. The latter concern may be irrelevant, of course, where the insured is high profile and its risks are reported as news. Where that is not the case, the insured should carefully consider which claims and losses to report and when.

3. FRAUD AND DISHONESTY EXCLUSIONS: Most D&O policies contain fraud and dishonesty exclusions. Typical language provides:

> This policy excludes coverage for claims "brought about or contributed to by the dishonest, fraudulent, criminal or malicious act or omission of such DIRECTOR or OFFICER if a final adjudication establishes that acts of active and deliberate dishonesty were committed or attempted with actual dishonest purpose and intent and were material to the cause of action so adjudicated."[4]

However, even under the typical D&O exclusion, coverage exists unless and until there has been a negative "final adjudication" of the fraud or dishonesty claim.[5] The key point here is that the insurer is obligated to pay defense costs, even in criminal cases, for potentially covered claims unless and until there has been a final adjudication against the insured that finds that the policyholder acted in a deliberately fraudulent or dishonest manner.

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4. PROFESSIONAL SERVICES EXCLUSIONS: A key issue for in-house attorneys and sometimes even risk managers performing insurance-related services is whether the entity's D&O policy contains an exclusion for "Professional Services." Such an exclusion may negate coverage for that individual—even if he or she is acting as a director or officer of the entity. It would typically provide that the insurer "shall not be liable to make any payment for Loss in connection with and Claim made against the Insured based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving the Insured's performance of or failure to perform professional services for others." Although the exclusion may seem alarmingly problematic when read on its own, it nevertheless appears in a number of D&O policies issued in the sports world. If in-house attorneys and risk managers want to be covered in one or more roles that may be deemed "professional services," they should seek an endorsement stating that they are covered for their professional services, notwithstanding any contrary reading of the relevant exclusion.

CONCLUSION

These are only a sampling of the many issues which could arise when analyzing coverage under a D&O policy for the claims or losses of a team, governing body, sports-related sponsor, or other business partner. The costs of defense and the liability for sports business-related claims are likely to be covered by one or more provisions within a D&O policy. An important consideration is that the policy language is not standard across the board. The most effective means to ensure coverage under these policies is to review the language carefully, resolve unfavorable policy terms in advance of a claim during the renewal process, and provide timely notice of a claim that arises during a policy period.

1. ISO Executive Liability Policy MP 00 01 04 03
2. Polychron v. Crum & Forster Ins. Cos., 916 F.2d 461, 462-63 (8th Cir. 1990).
3. Id.
4. In re Enron Corp. Sec., Derivative & "Erisa" Litig., 391 F. Supp. 2d 541, 559 (S.D. Tex. 2005).
5. The fraud exclusion has traditionally been subject to a "final adjudication" condition that obligates the insurer to fund the criminal and civil defense of directors or officers unless and until the fraud is finally adjudicated against the insured in the underlying case.