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Side A DIC Claim Scenarios: Privately Held Companies

Side A DIC coverage is designed to provide **last-line, non-rescindable protection for individual directors and officers** when:

- The company **cannot indemnify** (e.g., insolvency)
- The underlying D&O insurer **denies coverage**
- The underlying program is **exhausted**
- Coverage is **restricted by exclusions or policy limitations**

For privately held companies, Side A DIC is particularly critical given:

- Concentrated ownership **structures**
- Higher likelihood of **minority shareholder disputes**
- Exposure during **financial distress or bankruptcy**

1. Insolvency / Bankruptcy — Indemnification Fails

Scenario

A private equity-backed company files for bankruptcy following liquidity issues. A **bankruptcy trustee sues the board** alleging:

- Breach of fiduciary duty to creditors
- Deepening insolvency
- Preferential transfers

What Happens

- The company is legally **unable to indemnify directors and officers**
- The underlying ABC D&O policy:
  - Retention cannot be funded
  - Limits begin to erode quickly due to defense costs

Side A DIC Response

- **Drops down to provide first-dollar coverage** (no retention)
- Pays defense costs directly to individuals
- Protects personal assets of directors

Why DIC Matters

- Underlying carriers may **restrict payments in bankruptcy scenarios**
- Side A DIC is typically **non-rescindable and broader in scope**

2. Underlying Carrier Denial (Conduct Allegations)

Scenario

A minority shareholder files suit alleging:

- Fraud
- Intentional misrepresentation
- Self-dealing by executives

The underlying D&O insurer **denies coverage** based on conduct exclusions (pre-adjudication position).

What Happens

- Individuals face **significant defense costs with no carrier support**
- Coverage dispute delays funding

Side A DIC Response

- **Drops down over wrongful denial**
- Advances defense costs (subject to final adjudication language)

Why DIC Matters

- Side A DIC policies often have:
  - **Broader conduct wording (final non-appealable adjudication)**
  - Independent coverage grant unaffected by underlying denial

3 Exhaustion of Underlying Limits in a Multi-Party Claim

Scenario

A large shareholder dispute involves:

- Multiple directors and executives
- Entity allegations
- Parallel lawsuits

The primary and excess D&O towers are **exhausted due to defense costs and settlements.**

What Happens

- Remaining individuals still face ongoing litigation
- No remaining conventional D&O limits

Side A DIC Response

- **Provides excess coverage solely for individuals**
- Continues funding defense and settlements

Why DIC Matters

- Preserves coverage for individuals when:
  - Entity coverage has consumed traditional towers
  - Shared limits are exhausted

4. Rescission of Underlying D&O Policy

Scenario

Following a claim, the insurer attempts to rescind the primary D&O policy, alleging:

- Misrepresentations in the application
- Failure to disclose material financial issues

What Happens

- Coverage for all insureds is jeopardized
- Individuals face uninsured exposure

Side A DIC Response

- **Non-rescindable for innocent insureds**
- Continues to cover directors/officers despite rescission

Why DIC Matters

- Protects individuals from:
  - Application-related disputes
  - Actions of other executives (bad actor risk)

5. Excluded Claim Underlying Policy (But Covered Under DIC)

Scenario

A claim arises involving:

- Informal regulatory investigation that escalates
- Underlying policy **does not recognize it as a "Claim"**

What Happens

- No trigger under underlying policy definitions
- Individuals must fund legal defense themselves

Side A DIC Response

- Broader definitions allow **coverage to drop down**
- Pays defense costs directly

Why DIC Matters

- Side A DIC often includes:
  - Broader **"Claim" or "Investigation" triggers**
  - Expanded **Loss definitions**

6. Failure to Maintain Underlying Insurance (Program Gap)

Scenario

The company:

- Fails to renew excess D&O layers, ***or***
- Purchases inadequate limits

A significant claim exceeds available coverage.

What Happens

- Gap in insurance tower
- Individuals exposed above purchased limits

Side A DIC Response

- **Drops down to fill gaps in the tower**
- Acts as excess over available limits

Why DIC Matters

- Protects against:
  - Program design failures
  - Budget-driven reductions in limits

7. Lender / Creditor Claim with Retention Barrier

Scenario

A lender sues the board alleging misrepresentation in loan disclosures.

What Happens

- Company technically indemnifies
- But cannot fund the **large retention** required under ABC policy

Side A DIC Response

- **Drops down when indemnification "fails in fact"**
- Pays defense costs without requiring retention erosion

Why DIC Matters

- Practical inability to indemnify = trigger
- Critical in **cash-constrained environments**

8. Derivative Demand Where Indemnification Is Legally Restricted

Scenario

Investors bring a derivative claim alleging:

- Mismanagement
- Waste of corporate assets

In certain jurisdictions or circumstances:

- Company **cannot fully indemnify** directors

What Happens

- Individuals face partial personal exposure

Side A DIC Response

- Covers **non-indemnifiable loss**
- May respond where underlying coverage is constrained

Why DIC Matters

- Fills **legal gaps in indemnification frameworks**

9. Competing Claims Erode Shared ABC Limits

Scenario

Parallel claims arise:

- D&O claim
- EPLI-related matter
- Regulatory investigation

All draw from the same ABC tower.

What Happens

- Entity claims erode limits available for individuals

Side A DIC Response

- Ring-fenced coverage **exclusively for individuals**
- Protects against **limit dilution**

Why DIC Matters

- Prevents individuals from being:
  - **Subordinated to entity exposures**

10. Foreign Jurisdiction Claim – Indemnification Not Permitted

Scenario

A director of a U.S.-based private company sits on a foreign subsidiary board.

Local law:

- Restricts indemnification
- Limits insurance recovery

What Happens

- Local exposure for individual director

Side A DIC Response

- **Responds where indemnification is prohibited by law**
- Provides direct protection

Why DIC Matters

- Critical for:
  - Cross-border governance
  - International board participation

Key Takeaways for Clients

When Side A DIC Is Most Valuable

- Financial distress / insolvency
- Coverage disputes with underlying carriers
- High-severity, multi-party litigation
- Complex ownership and governance structures

Core Structural Advantages

- **Non-rescindable coverage**
- **Broad insuring agreement (Side A only)**
- **Drop-down capability**
- **No retention in many cases**
- **Dedicated limits for individuals**