

## Unique Insurance Issues Faced by Cooperatives: You Only *Thought* You Were Covered

*By Robert Hensley*

Imagine yourself as the CFO or as a director of a cooperative and a lawsuit gets served on you - one that names you *personally* as a defendant. The lawsuit has been filed by Mr. John Notsohappy, a member of the cooperative who 10 years earlier served as a director of the company. Mr. Notsohappy claims in his lawsuit that you mismanaged the company. Even worse, Mr. Notsohappy's lawsuit claims that you cost the cooperative millions of dollars and seeks to recover against your personal assets. Thoughts of personal bankruptcy race through your mind.

You breathe into a paper bag and after a few anxious moments, you remember something called a D&O policy that the cooperative bought a few months back from an insurance company called Nihil Insurance Company. You start calling around the company to find a copy of the policy, and after a couple of days, you receive a partial copy of the Directors and Officers Insurance Policy issued by Nihil Insurance Company, an offshore subsidiary of another insurance company about which you also know nothing. Nevertheless, you start to feel better - the declarations page states that there is \$10 million in coverage! However, you read a little further, and find that the policy has a \$1 million deductible that must be paid by the insured and that the insurance company does not have a duty to defend the lawsuit; instead, it only has a duty to pay for any damages you must pay that are in excess of \$1 million. You start to get a weak feeling in your stomach as you realize that the cooperative may not have that much cash on hand. You decide to call the lawyer for the cooperative.

The lawyer for the cooperative immediately "tenders" the defense of Mr. Notsohappy's lawsuit to Nihil Insurance Company. Because Nihil Insurance Company does not have a duty to defend the lawsuit, you must hire your own lawyer. Fortunately, the cooperative has agreed to cover your legal costs. Unfortunately, the cooperative has indicated that if you are found by a jury to have breached your fiduciary duty to the cooperative, that the cooperative will seek reimbursement of the legal costs it has advanced to you and that it will not pay any portion of the \$1 million deductible. You get that sinking feeling again and go to your therapist.

Then, after a three month delay, Nihil Insurance Company writes to you and informs you that the D&O policy does not provide coverage for three reasons: (1) the policy excludes coverage for claims by "members" of the cooperative; (2) the "SEC Exclusion" in the policy excludes coverage for a claim by a stockholder; and (3) the "Insured versus Insured Exclusion" excludes coverage for the claim by the former director because as a former director he is still an "insured" under Nihil's insurance policy.

You seek further counseling from your therapist, only to find that the cooperative's health plan does not provide coverage for mental disorders.

Seem far fetched? It's not. The scenario outlined above has happened on more than one occasion. Some insurance companies who write D&O policies are taking ever more aggressive positions with respect to denying coverage. In fact, some D&O providers are even sending out new endorsements *after* the initial

coverage is obtained which indicate that they are unilaterally excluding coverage for any claim by a member of a cooperative! It's highly questionable whether a court would sustain such practices, but it's happening again and again.

### *What Can You Do?*

If the courts allow insurance companies to unilaterally change the coverage after the fact, the answer is probably not much. However, there are a few simple steps to take when obtaining and maintaining insurance policies:

- It is probably in the interest of the cooperative to use an insurance broker to obtain and review the coverage.
- Obtain a “specimen” of the insurance policy before the policy is issued and negotiate the terms of the policy. Be especially wary of “exclusions.”
- Have the broker provide a detailed summary of the coverage to the officers and directors.
- Some insurers wait months before sending out a copy of the policy. Request that the broker obtain a final copy of the policy within 30 days of when the policy is “bound.”
- Request that the broker review the final policy to make sure that it is in conformity with the specimen that was received and the negotiated amendments.
- If the cooperative receives a new “Endorsement” to the policy, the Endorsement needs to be carefully reviewed, and any inconsistencies should be raised with the insurer and objected to in writing.

### *What About Your Other Insurance?*

The issues with D&O policies are just the tip of the iceberg. Many more questions can and should be asked:

- Has anyone recently (or ever) reviewed your entire insurance portfolio? Are the limits sufficient?
- Does your product liability insurance provide coverage if you erroneously sell a food product that contains genetically modified corn?
- Do your product liability and/or property insurance policies provide coverage for “acts of terrorism” that impact your business?
- Do you have coverage for a claim by a plant worker against the president of the company for sexual discrimination? Wrongful termination? Slander?
- Do you have coverage for a false advertising claim brought by a competitor?
- Do you have coverage for a claim by a competitor for alleged anti-competitive actions?
- Is the “risk of loss” provision in your sales contract with customers consistent with your property insurance policy?

None of these are easy issues. However, a thoughtful review of your current coverage is the first step to protecting your company, your officers, and your directors. The next step is to remain vigilant and protect your rights. One thing is a given, you can probably bet that the insurance company is already a step ahead of you.

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