

**A COMPARATIVE STUDY OF D&O LIABILITY  
INSURANCE IN THE U.S. AND SOUTH KOREA:  
PROTECTING DIRECTORS AND OFFICERS FROM  
SECURITIES LITIGATION**

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# I. Introduction

## A. Background

Directors and officers liability insurance (D&O insurance) is a special type of insurance which provides coverage for losses arising from claims made against directors and officers of corporations.<sup>1</sup> Legal problems relating to D&O insurance have created significant issues in the U.S. for many years.<sup>2</sup> Due to the high number of securities lawsuits in the U.S., corporate managers are exposed to huge financial risk in their roles as directors and officers.<sup>3</sup> D&O insurance functions as the main source of protection from such risks because it can make up for losses directly and effectively.<sup>4</sup>

D&O insurance was first introduced in the U.S. soon after the Securities Act of 1933 (“1933 Act”) and the Securities Exchange Act of 1934 (“1934 Act”). Today, most public corporations in the U.S. purchase D&O insurance to protect directors and officers, as well as the corporation itself.<sup>5</sup> Moreover, as the risk of securities litigation increases after the enactment of the Sarbanes-Oxley Act of 2002, it has become essential that corporations purchase insurance for

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<sup>1</sup> See AM. INT’L GROUP (AIG), EXECUTIVE AND ORGANIZATION LIABILITY INSURANCE POLICY § 1 (Feb. 2000), [http://www.chartisinsurance.com/Public-Company-Directors-and-Officers-Insurance-DandO-22000\\_295\\_195857.html](http://www.chartisinsurance.com/Public-Company-Directors-and-Officers-Insurance-DandO-22000_295_195857.html) (U.S. D&O policy) This link leads to Chartis’ website because AIG General Insurance has changed its name to “Chartis.” Reuters, American International Group, Inc. (AIG.N), <http://www.reuters.com/finance/stocks/companyProfile?symbol=AIG.N&WTmodLoc=NewsArt-C1-ArticlePage1>; See also HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], IM WON BAE SANG CHAEK IM BO HUM YAK KWAN [DIRECTORS AND OFFICERS LIABILITY AND COMPANY REIMBURSEMENT POLICY] § 2, [http://b2b.hi.co.kr/file/prd/compen/pro\\_01\\_1.pdf](http://b2b.hi.co.kr/file/prd/compen/pro_01_1.pdf) (last visited June 1, 2009) (Korean version of D&O policy); See also HYUNDAI MARINE & FIRE INS., DIRECTORS AND OFFICERS LIABILITY AND COMPANY REIMBURSEMENT POLICY § 1, [http://b2b.hi.co.kr/file/prd/compen/pro\\_01\\_2.pdf](http://b2b.hi.co.kr/file/prd/compen/pro_01_2.pdf) (last visited June 1, 2009) (English version of D&O policy).

<sup>2</sup> See Joseph P. Monteleone, *Recent Significant and Decisions in Securities Litigation and Related Disputes Affecting D&O Insurers*, 1692 PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES 753 (2008).

<sup>3</sup> JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 899 (5th ed. 2000).

<sup>4</sup> Carolyn H. Rosenberg, *Insurance Coverage and Securities Litigation Resolution*, N98SLIB A.B.A. CENTER FOR CONTINUING LEGAL EDUC. 9 (1998).

<sup>5</sup> Joseph P. Monteleone, *Directors’ and Officers’ Liability Insurance: The Sarbanes-Oxley Act of 2002 and Other Topical Issues*, SH077 A.L.I.-A.B.A. CONTINUING LEGAL EDUC. 313 (2002).

directors and officers and that these officials identify the limits of the protection.<sup>6</sup> In particular, the recent litigation for losses arising from subprime lending in the U.S. has prompted an interest in D&O insurance issues.<sup>7</sup> Until recently, however, the judicial guidance in this area was not sufficient, and many of the issues involved in D&O insurance coverage remained unsolved. In light of such problems, it is necessary to reassess the current D&O insurance system in order to provide financial protection to directors and officers as well as encourage capable and responsible individuals to accept positions in corporate management.<sup>8</sup>

As the financial risk of securities litigation increases after the Korean economic crisis, D&O insurance is considered a significant issue in Korea as well.<sup>9</sup> The D&O insurance system was introduced to Korea in 1991.<sup>10</sup> The need for insurance, however, was not emphasized until the Korean economic crisis in 1997, when the first shareholders' lawsuits in Korea were brought against Korea First Bank.<sup>11</sup> The risk of shareholder litigations triggered interest in D&O

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<sup>6</sup> See JOHN F. OLSON ET AL., *DIRECTOR AND OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE* § 1:1, at 1-6 to -7 (2003).

<sup>7</sup> See John F. McCarrick, *Subprime Claims: D&O and E&O Liability and Coverage Implications*, 775 PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES 299, 303 (2008); *Id.* at 305-06 (explaining that claims are made against corporate managers for "breaches of fiduciary duty or violations of federal or state securities laws in managing or disclosing the corporation's financial exposure to subprime losses."); Donna L. Wilson, *Insurance Coverage Issues in the Subprime Credit Context: Bankruptcy, Insurance, and the Subprime Lender*, 1668 PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES 855, 859 (2008) (explaining that subprime lenders may face "suits by borrowers alleging violations of federal credit laws and state consumer protection statutes...shareholder suits alleging violation of the securities laws...and issuer/underwriter suits alleging a failure to buy back loans...suits brought by state attorneys general").

<sup>8</sup> Seth Van Aalten, *D&O Insurance in the Age of Enron: Protecting Officers and Directors in Corporate Bankruptcy*, 22 ANN. REV. BANKING & FIN. L. 457, 460 (2003).

<sup>9</sup> See Jong-Sung Eun, *Im won deung eui Bae sang chaek im bo hum gum yung sang poom ye Kwan han Bub juk Go chal [A Study on the Director's and Officer's Liability Insurance]*, SANG POOM HAK EYUN GU JE24KWON 1HO [J. OF COMMODITY SCI. & TECH. VOL. 24-1] 23, 24 (2006).

<sup>10</sup> Jin-Hee Hong, *Im won bae sang chaek im bo hum yak kwan sang We bub haeng we myun chaek sa you eui Hae suk kwa Je moon je [Construction and Several Problems of Conduct Exclusions in the Director's and Officer's Liability Policy]*, KI UP BUB EYUN GU JE21KWON JE4HO(TONG KWON JE31HO) [BUS. L. VOL.21-4(31)] 181, 182 (2008).

<sup>11</sup> Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency)*, 2008 COLUM. BUS. L. REV. 1, 84 (2008).

insurance in South Korea.<sup>12</sup> Furthermore, the Korean government reduced the requirements for shareholder derivative suits in 1998 and established a U.S.-style securities class action system in 2004.<sup>13</sup> Having seen the abuse of securities class action in the U.S., Korean corporations feared potential losses and began to purchase D&O insurance for their officers and directors.<sup>14</sup>

In addition, the Korea-U.S. Free Trade Agreement was signed in 2007, followed by the Korean Foreign Legal Consultants Act, which was enacted in 2009. These acts allowed U.S. law firms to establish offices in Korea.<sup>15</sup> As a result, a number of U.S. law firms with class action knowledge and experience will be able to work in Korea.<sup>16</sup> Only one securities class action lawsuit has ever been filed in Korea, even though the law permitting securities class actions was enacted in 2004.<sup>17</sup> One possible reason for this inactivity is that Korean law firms avoid representing clients in shareholder initiated lawsuits where the corporation may be a prospective client.<sup>18</sup> Furthermore, smaller Korean law firms cannot advance litigation expenses or bear the monetary losses resulting from losing the suit.<sup>19</sup> It is expected, however, that the amount of class action filing will increase because U.S. law firms, unrelated to Korean corporations, will represent plaintiffs once Korean legal markets are open to them.<sup>20</sup> As a result, Korean corporate directors and officers will be pushed into the financial risk of securities litigation. Under these

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<sup>12</sup> Eun, *supra* note 9, at 24.

<sup>13</sup> Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1508-09 (2004).

<sup>14</sup> Eun, *supra* note 9, at 24.

<sup>15</sup> Rahn Kim, *Foreign Lawyers to Provide Limited Service*, KOREA TIMES, Oct. 20, 2008, [http://www.koreatimes.co.kr/www/news/nation/2008/02/117\\_18564.html](http://www.koreatimes.co.kr/www/news/nation/2008/02/117_18564.html). However, the Korea-U.S. Free Trade Agreement is not yet approved by their respective congresses. Kyungho Choi, *Korean Foreign Legal Consultants Act: Legal Profession of American Lawyers in South Korea*, 11 ASIAN-PAC. L. & POL'Y J. 100, 102 (2010). Thus, “[d]espite enactment of the [Foreign Legal Consultants] Act, U.S. lawyers and law firms need to wait until the ratification of the [Agreement] by both countries in order to benefit from the [Act].” *Id.*

<sup>16</sup> See Kim, *supra* note 15; Choi, *supra* note 15, at 102-04.

<sup>17</sup> Kim Rahn, *First Class-Action Suit in Offing*, KOREA TIMES, June 25, 2009, [http://www.koreatimes.co.kr/www/news/nation/2009/06/113\\_47475.html](http://www.koreatimes.co.kr/www/news/nation/2009/06/113_47475.html).

<sup>18</sup> Black et al., *supra* note 11 at 22.

<sup>19</sup> *Id.*

<sup>20</sup> See *id.*; Choi, *supra* note 13 at 1517; Kim, *supra* note 15.

circumstances, it will be essential for large corporations to purchase D&O insurance in Korea as well.<sup>21</sup>

Despite the apparent need, the Korean legal system is not prepared to address the issues surrounding D&O insurance.<sup>22</sup> In addition, Korean courts do not have sufficient experience in this kind of insurance practice.<sup>23</sup> This is inferred from the following facts: first, the Korea Commercial Act does not provide standards for D&O insurance.<sup>24</sup> Thus, in disputes involving D&O insurance, the court can rely only on policy forms used in practice.<sup>25</sup> Second, there are only three Supreme Court cases concerning D&O insurance in Korea since 1991.<sup>26</sup> This lack of statutes and prior cases makes it difficult for the court to decide on such matters. Third, D&O policy in Korea exists in two forms: a Korean version and an English version.<sup>27</sup> Not only are these policies written in different languages but they also differ in content.<sup>28</sup> The Korean version is used only for domestically insured corporations.<sup>29</sup> The English version is used for corporations which need reinsurance by international insurers.<sup>30</sup> The coexistence of these two very different documents is a source of confusion.<sup>31</sup>

Unlike in Korea, a number of cases regarding D&O insurance have been decided in the U.S., and controversial issues have provided many opportunities for the courts to set precedent.<sup>32</sup>

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<sup>21</sup> See Hong, *supra* note 10, at 182.

<sup>22</sup> See *id.* at 183.

<sup>23</sup> See *id.*

<sup>24</sup> Black et al., *supra* note 11, at 85.

<sup>25</sup> *Id.*

<sup>26</sup> See Dae bub won [Supreme Court] 2003 15297 (S.Korea); Dae bub won [Supreme Court] 2003 19053 (S.Korea); Dae bub won [Supreme Court] 2002 69259 (S.Korea); Jeong Seo, *Im won bae sang chak im bo hum [D&O Liability Insurance]*, MIN SA PAN RAE YEON GU XXIX [CIV. CASE REV. XXIX] 1079, 1084 (2007).

<sup>27</sup> Eun, *supra* note 9, at 26.

<sup>28</sup> See *id.*

<sup>29</sup> Hong, *supra* note 10, at 181.

<sup>30</sup> *Id.*

<sup>31</sup> See Hyo Jun Park, *Ee sa eui Chaek im Je han ye Kwan han Eyun gu [A Study on the Limitation of the Director's Liability]*, 150 (Dec. 2005) (unpublished Ph.D. dissertation, Changwon National University).

<sup>32</sup> See generally Robert H. Shulman et al., *Hot Issues in D&O Insurance*, 719 PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES 205 (2005) (explaining current issues regarding D&O insurance).

The examination of the current issues concerning U.S. D&O insurance is helpful not only to the U.S., but to Korea as well, because both countries have a number of common elements of D&O policy. Moreover, the comparative study in this area will be useful to other countries governed by civil law which plan to adopt U.S.-style D&O insurance systems.

## **B. Purpose and Synopsis**

The purpose of this paper is to provide ways to better protect corporate directors and officers from the burdens of securities litigation through a comparison of D&O insurance in the U.S. and South Korea. As the financial risk of securities litigation increases, D&O insurance is considered a significant issue not only in the U.S., but in Korea as well. Until recently, however, the jurisprudence in this area was not developed; thus, many problems in this area of law remain unresolved. This paper examines the current issues concerning D&O insurance in the U.S. and South Korea, and provides recommendations for the Korean D&O insurance system by referencing the U.S. D&O insurance system.

The body of this paper is composed of six chapters. Chapter I lays out the background and purpose of this study. Chapter II discusses the role of D&O insurance in securities litigation. This chapter addresses how D&O insurance protects directors, officers, and corporations from the burdens of derivative litigation and class action litigation. It also deals with the relationship between indemnification and D&O insurance. In addition, this chapter examines how D&O insurers monitor corporate governance.

Chapter III provides an overview of the Korean D&O insurance system. This chapter analyzes components of Korean D&O policy, including the scope of coverage and exclusion. It



compares and contrasts the two current versions of Korean D&O policy. The examination of these policies is very meaningful because it is the basis for a potential solution to many of the problems in Korean D&O insurance.

Chapter IV compares the U.S. and South Korean D&O insurance systems. This chapter addresses controversial issues arising in the U.S. or South Korea: whether the corporation can pay an insurance premium for officials, whether the insurance covers defense and settlement costs, whether defense costs are advanced, and whether the insurers have an obligation to defend the insured in securities litigations. In addition, this chapter discusses allocation issues and coverage exclusions.

Chapter V offers recommendations for the reform of the Korean D&O insurance system. The proposed reform is based on discussions in chapters II, III and IV. This chapter contains suggestions regarding the reconsideration of mandatory disclosure of D&O insurance information, the reform of the Korean Commercial Act, the reform of the contents of D&O policy, and the specification of guidelines for D&O insurance coverage in litigation.

## **II. The Role of D&O Liability Insurance in Securities Litigation**

### **A. Protection Against the Burdens of Securities Litigation**

Corporate directors and officers are exposed to securities litigation risks as a part of normal business operations.<sup>33</sup> During day-to-day management, they are subject to fiduciary duties of care, loyalty, and good faith.<sup>34</sup> If the officials violate their fiduciary duties, the corporation may seek damages by bringing a lawsuit against them.<sup>35</sup> Even if the corporation opts not to initiate litigation, shareholders can often bring a derivative action against officials on behalf of the corporation.<sup>36</sup> Furthermore, shareholders may bring a securities class action directly against directors and officers if their acts constitute securities fraud.<sup>37</sup>

This potential litigation risk may discourage directors and officers from actively managing their business.<sup>38</sup> Without adequate protection from personal liability, talented individuals may not be willing to work as directors or officers, realizing that the rewards may not be worth the risks.<sup>39</sup> D&O insurance is designed to avoid such risks and to allow talented executives to have top positions within corporations.<sup>40</sup> The fundamental purpose of D&O insurance is to protect individual directors and officers from the costs of litigation,<sup>41</sup> and thus it functions as the main source of protection from such risks.<sup>42</sup>

However, the protections offered by D&O insurance are not limited to individual directors and officers; D&O insurance also protects the corporation itself from securities

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<sup>33</sup> See Aalten, *supra* note 8, at 457.

<sup>34</sup> CHARLES R. T. O'KELLY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS 235 (5th ed. 2006).

<sup>35</sup> *Id.* at 237.

<sup>36</sup> *Id.*

<sup>37</sup> See JOHN H. MATHIAS, JR. ET AL., DIRECTORS AND OFFICERS LIABILITY : PREVENTION, INSURANCE AND INDEMNIFICATION § 3.01, at 3-3 (2002); See also Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlement*, 157 U. PA. L. REV. 755, 764 (2009).

<sup>38</sup> Matthew Benjamin, *Risky Business: Life in the Executive Suite is Taking a Sour Turn*, U.S. NEWS & WORLD REPORT, Sept. 9, 2002, available at [http://www.usnews.com/usnews/biztech/articles/020909/archive\\_022500.htm](http://www.usnews.com/usnews/biztech/articles/020909/archive_022500.htm).

<sup>39</sup> See *id.*

<sup>40</sup> See Aalten, *supra* note 8, at 460.

<sup>41</sup> *Id.* at 470.

<sup>42</sup> Rosenberg, *supra* note 4, at 9.

litigation burdens.<sup>43</sup> Ultimately, the protective function of D&O insurance is accomplished through three types of coverage: Side A, Side B, and Side C.<sup>44</sup> Side A coverage directly protects individual directors and officers; Side B coverage reimburses the corporation; and Side C coverage protects the corporation itself.<sup>45</sup> Although Side B appears to cover the corporation, the fundamental purpose of covering indemnification is to protect individual directors and officers.<sup>46</sup>

Side A coverage is the personal part of D&O insurance.<sup>47</sup> This coverage protects individual directors and officers by insuring against loss where the corporation does not indemnify its managers.<sup>48</sup> In particular, the insurer will pay managers for loss under Side A coverage when the corporation refuses to or cannot indemnify them due to a derivative action or a corporation's insolvency.<sup>49</sup>

Side B coverage is the portion of D&O insurance which offers company reimbursement.<sup>50</sup> This coverage does not apply to directors and officers, but rather the corporation, for it reimburses the corporation for expenses to indemnify its directors and officers.<sup>51</sup> Side B coverage arises only when the corporation indemnifies its directors and officers.<sup>52</sup> The scope of coverage is also limited to the extent of indemnification.<sup>53</sup> Thus, if corporate managers cannot be indemnified, then Side B coverage is not allowed.<sup>54</sup>

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<sup>43</sup> David B. Parker, *The Role of Liability Insurance in Securities Litigation*, 491 PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES 373 (1985).

<sup>44</sup> Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1164-65 (2006).

<sup>45</sup> *Id.* at 1163-67.

<sup>46</sup> See Aalten, *supra* note 8, at 470.

<sup>47</sup> WILLIAM E. KNEPPER & DAN A. BAILEY, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* § 23.02, at 23-3 (7th ed. 2006).

<sup>48</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 1; See KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-3.

<sup>49</sup> See John Collen, *Bankruptcy and D&O Insurance*, 11 J. BANKR. L. & PRAC. 121, 122 (Jan.-Feb. 2002); Griffith, *supra* note 44, at 1166.

<sup>50</sup> KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-3.

<sup>51</sup> See AM. INT'L GROUP (AIG), *supra* note 1, § 1(ii); KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-3.

<sup>52</sup> Griffith, *supra* note 44, at 1165.

<sup>53</sup> See AM. INT'L GROUP (AIG), *supra* note 1, § 1(ii).

<sup>54</sup> See Griffith, *supra* note 44, at 1165.

Side C coverage is the corporate liability part of D&O insurance.<sup>55</sup> This coverage protects the entity itself by insuring loss from claims made against the corporation.<sup>56</sup> Side C is not traditionally included as part of the coverage.<sup>57</sup> Thus, the corporation itself is not protected unless the policy stipulates that the corporation's losses be covered.<sup>58</sup> Currently, however, a number of D&O policies include the entity coverage.<sup>59</sup>

However, a concern involved with most insurance policies is known as the "moral hazard" problem, which addresses carelessness on the part of the insured.<sup>60</sup> D&O insurance also invites this problem because protecting corporate directors and officers from the burdens of securities litigation may encourage lax behavior on the part of management.<sup>61</sup> Securities litigation is designed to prevent the misconduct of managers,<sup>62</sup> while D&O insurance is intended to protect the managers from the litigation burdens.<sup>63</sup> Therefore, D&O insurance could weaken the deterrent function of securities litigation and increase corporate misconduct.<sup>64</sup>

In light of this problem, D&O insurers have taken various measures to prevent moral hazards.<sup>65</sup> First, most D&O insurers incorporate deductibles in their coverages.<sup>66</sup> Therefore, if a claim is made against a director or an officer, the individual official or the company is obligated

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<sup>55</sup> Rosenberg, *supra* note 4, at 12.

<sup>56</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 1(i); KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-4.

<sup>57</sup> See OLSON ET AL., *supra* note 6, §§ 12:20, 12:36; See also KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-4.

<sup>58</sup> See KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-3.

<sup>59</sup> *Id.* § 23.02, at 23-4.

<sup>60</sup> See Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 238-39 (1996); See also Peter Margulies, *Legal Hazard: Corporate Crime, Advancement of Executives' Defense Costs, and the Federal Courts (Part I)*, 7 U.C. DAVIS BUS. L.J. 2 (2006), <http://blj.ucdavis.edu/article/641/>.

<sup>61</sup> See Margulies, *supra* note 60.

<sup>62</sup> Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 78 (2008).

<sup>63</sup> See Aalten, *supra* note 8, at 460.

<sup>64</sup> See Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1817-19 (2007).

<sup>65</sup> See *id.* at 1819-20.

<sup>66</sup> See, e.g., CHUBB CORP., EXECUTIVE PROTECTION PORTFOLIO: DIRECTORS' AND OFFICERS' LIABILITY COVERAGE SECTION § 7 (May 2007), available at <http://www.chubb.com/international/australia/csi/chubb4263.pdf>; See also Baker & Griffith, *supra* note 64, at 1819.

to pay the deductible.<sup>67</sup> Second, most D&O policies have coverage limitations.<sup>68</sup> Therefore, when actual losses exceed the coverage limits, the individual official must pay the excess loss.<sup>69</sup> Third, D&O insurers attempt to discourage moral hazards by providing specific exclusions for “dishonesty and fraud.”<sup>70</sup> Finally, D&O insurers attempt to monitor managers in order to prevent misconduct among directors and officers.<sup>71</sup> This function of D&O insurance is expected to mitigate the moral hazard problem because D&O insurers have the incentive and expertise to effectively monitor a corporation.<sup>72</sup> Part C of this chapter specifically addresses this monitoring role.

## **B. The Relationship Between Indemnification and D&O Insurance**

In the U.S., corporations are generally allowed to purchase D&O insurance for directors and officers.<sup>73</sup> In most states (other than New York<sup>74</sup>), corporations can purchase such coverage whether or not they are able to indemnify their managers.<sup>75</sup> Therefore, D&O insurance can

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<sup>67</sup> See Baker & Griffith, *supra* note 64, at 1819.

<sup>68</sup> See, e.g., AM. INT’L GROUP (AIG), *supra* note 1, § 5; CHUBB CORP., *supra* note 66, § 7; See also Baker & Griffith, *supra* note 64, at 1819.

<sup>69</sup> See Baker & Griffith, *supra* note 64, at 1819.

<sup>70</sup> See, e.g., AM. INT’L GROUP (AIG), *supra* note 1, § 4(c); CHUBB CORP., *supra* note 66, § 4.A(ix); See also Baker & Griffith, *supra* note 64, at 1820; KNEPPER & BAILEY, *supra* note 47, § 25.03, at 25-9.

<sup>71</sup> See Clifford G. Holderness, *Liability Insurers as Corporate Monitors*, 10 INT’L REV. L. & ECON. 115, 128 (1990).

<sup>72</sup> John E. Core, *The Directors’ and Officers’ Insurance Premium: An Outside Assessment of the Quality of Corporate Governance*, 16 J.L. ECON. & ORG. 449, 450 (2000); Griffith, *supra* note 44, at 1174.

<sup>73</sup> See DEL. CODE ANN. tit. 8, § 145(g) (2001); MODEL BUS. CORP. ACT § 8.57 (2008).

<sup>74</sup> See Bennett L. Ross, *Protecting Corporate Directors and Officers: Insurance and Other Alternatives*, 40 VAND. L. REV. 775, 784-85 (1987) (explaining that the New York state restricts D&O coverage).

<sup>75</sup> *Id.* at 784.

protect directors and officers beyond the coverage of the indemnification.<sup>76</sup> D&O insurance also fills the void in instances where a corporation does not indemnify its managers.<sup>77</sup>

D&O insurance becomes more meaningful in circumstances where the corporation does not provide indemnification.<sup>78</sup> First, if directors and officers do not act “in good faith”<sup>79</sup> or “in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation,”<sup>80</sup> or if directors have reasonable cause to believe the person’s conduct was unlawful,<sup>81</sup> then the directors and officers are not allowed to be indemnified.<sup>82</sup> However, in the absence of specific limitations in the policy, D&O insurance is able to cover these cases.<sup>83</sup>

Second, D&O insurance covers non-indemnifiable loss in situations involving derivative actions and public policy prohibitions.<sup>84</sup> In the case of derivative actions, corporations are not allowed to indemnify managers for judgments or settlement sums, whereas D&O insurance can reimburse them for sums paid.<sup>85</sup> According to the Delaware General Corporation Law

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<sup>76</sup> *Id.*

<sup>77</sup> See AM. INT’L GROUP (AIG), *supra* note 1, § 1; See also KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-3.

<sup>78</sup> See OLSON ET AL., *supra* note 6, § 12:3, at 12-9 to -10.

<sup>79</sup> DEL. CODE. ANN. tit. 8, § 145(a), (b); MODEL BUS. CORP. ACT § 8.51(a)(1)(i).

<sup>80</sup> DEL. CODE. ANN. tit. 8, § 145(a), (b).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*; MODEL BUS. CORP. ACT § 8.51(a)(1).

<sup>83</sup> See DEL. CODE. ANN. tit. 8, § 145(g); See also MODEL BUS. CORP. ACT § 8.57.

<sup>84</sup> See OLSON ET AL., *supra* note 6, § 12:3, at 12-10.

<sup>85</sup> Compare DEL. CODE. ANN. tit. 8, § 145(a), with *id.* § 145(b); See also OLSON ET AL., *supra* note 6, § 5:19, at 5-40. In addition, S. Samuel Arsht and Walter K. Stapleton commented on these provisions as follows:

It was ultimately determined that the statute should authorize only the indemnification of litigation expenses and not of amounts paid in satisfaction of a judgment or in settlement of a claim. To permit the corporation to nullify a judgment in its favor against a director simply by refunding the director’s payment on it would, in the committee’s judgment, subvert the substantive provisions of the corporation law and should not be permitted. With respect to payments in settlement of a derivative action, it was the committee’s view that to permit such indemnification would have the ultimate effect of discouraging settlements since, in such a situation, derivative plaintiffs could demonstrate no benefit arising to the corporation from their action and, presumably, could not justify being reimbursed for their litigation expenses, including counsel fees.

S. Samuel Arsht & Walter K. Stapleton, *Delaware’s New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 79-80 (1967).

(“Delaware G.C.L.”), although corporations are generally allowed to indemnify managers for expenses, judgments, fines and settlement sums,<sup>86</sup> in claims made “by or in right of the corporation,” the indemnification is limited to expenses.<sup>87</sup> However, the law does not contain such limitations for D&O insurance.<sup>88</sup> Therefore, expenses, as well as judgments and settlements arising in derivative action are insurable.<sup>89</sup>

Furthermore, corporations are prohibited from indemnifying managers for violations of the federal securities laws, but they are allowed to purchase insurance for their managers to cover liabilities relating to these laws.<sup>90</sup> For example, the U.S. Securities and Exchange Commission (“SEC”) has not allowed indemnification for violation of the 1933 Act on the grounds that such indemnification goes against public policy.<sup>91</sup> According to the SEC, Congress primarily sought to “stimulate diligence on the part of those persons who are actually responsible for the preparation of registration statements” in the enactment of Section 11 of the 1933 Act.<sup>92</sup> Therefore, “it is clearly contrary to public policy to allow directors to avoid any consequences for their lack of diligence... by indemnification from the issuer.”<sup>93</sup>

In contrast, the SEC has considered insurance for liabilities under the 1933 Act permissible, regardless of whether a corporation funds the insurance premiums.<sup>94</sup> Although public policy concerns about moral hazard have likewise been raised in the context of D&O

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<sup>86</sup> DEL. CODE. ANN. tit. 8, § 145(a).

<sup>87</sup> *Id.* § 145(b).

<sup>88</sup> *See id.* § 145.

<sup>89</sup> Ross, *supra* note 74, at 785-86.

<sup>90</sup> *Id.* at 786; *See also* DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT: CASE AND MATERIALS 205 (2nd ed. 2007) (explaining that courts consider indemnification as contrary to public policy when defendants intentionally violate the federal securities laws).

<sup>91</sup> *See* 17 C.F.R. §§ 229.510, .512(h)(3) (2008); Ross, *supra* note 74, at 786.

<sup>92</sup> Joseph W. Bishop, Jr., *New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under the Federal Securities Laws*, 1972 DUKE L.J. 1153, 1162 (1972) (quoting Brief for SEC as Intervenor, *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971)).

<sup>93</sup> *Id.*

<sup>94</sup> *See* 17 C.F.R. § 230.461(c); Ross, *supra* note 74 at 786.

insurance, the SEC has drawn a distinction between indemnification and insurance.<sup>95</sup> While the SEC has not provided specific reasons, it can be supposed that several issues have been taken into consideration: that a qualified person is reluctant to serve as a manager without adequate protection from the burdens of securities litigation;<sup>96</sup> that recruiting a talented manager benefits shareholder interests;<sup>97</sup> that insurance premiums funded by a corporation are comparably small;<sup>98</sup> that insurance coverage is already restricted under various exclusions and insurance laws;<sup>99</sup> and that insurers regularly monitor the conduct of managers to prevent moral hazards.<sup>100</sup> Given these considerations, it is understandable that the SEC draws distinctions between D&O insurance and indemnification in the case of liabilities under the federal securities laws.<sup>101</sup>

Finally, D&O insurance serves an important function even when indemnification not permissible.<sup>102</sup> Only D&O insurance can cover losses when a corporation cannot afford to indemnify directors and officers due to insolvency or financial problems.<sup>103</sup> Moreover, some corporations may not be legally obligated to indemnify managers shortly after a hostile merger.<sup>104</sup>

### C. Monitoring Corporate Governance

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<sup>95</sup> See KNEPPER & BAILEY, *supra* note 47, § 22.21, at 22-50.11.

<sup>96</sup> Dror Futter, *Model Indemnification Agreement*, 1660 PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES 309, 315 (2008).

<sup>97</sup> See generally MATHIAS ET AL., *supra* note 37, § 1.01, at 1-3.

<sup>98</sup> Milton P. Kroll, *Some Reflections on Indemnification Provisions and S.E.C. Liability Insurance in the Light of Barchris and Globus*, 24 BUS. LAW. 681, 689 (1969).

<sup>99</sup> Futter, *supra* note 96, at 314.

<sup>100</sup> See Holderness, *supra* note 71 at 128; Core, *supra* note 72 at 475.

<sup>101</sup> See KNEPPER & BAILEY, *supra* note 47, § 22.21, at 22-50.11.

<sup>102</sup> Ross, *supra* note 74, at 786.

<sup>103</sup> See OLSON ET AL., *supra* note 6, § 12:3.

<sup>104</sup> Ross, *supra* note 74, at 786.



D&O insurance is considered to have great potential to monitor corporate governance because it regularly assesses D&O risks when determining premium amounts.<sup>105</sup> This monitoring role of D&O insurance may reduce the moral hazard problem because D&O insurers have the incentive and expertise to prevent manager misconduct.<sup>106</sup>

Corporate governance is a crucial factor in establishing D&O premiums.<sup>107</sup> Generally, poor corporate governance tends to trigger securities litigation.<sup>108</sup> Therefore, in order to avoid claims on the policy, each insurance company uses its own assessment methods to assess D&O risks before extending an insurance agreement.<sup>109</sup> Each company's goal is to accurately assess the risk in order to calculate the proper insurance premium.<sup>110</sup> D&O insurance companies, therefore, classify corporations into two groups: 1) corporations with high risk corporate governance and 2) corporations with low risk corporate governance.<sup>111</sup>

D&O insurers will cover companies with good corporate governance for low premiums, whereas companies with poor corporate governance are required to pay high premiums.<sup>112</sup> If shareholders are able to effectively restrict the conduct of managers within a corporation, D&O insurers will consider the corporation to have good governance.<sup>113</sup> However, if shareholders are not able to regulate managerial conduct, the corporation is considered to have poor governance.<sup>114</sup> Therefore, D&O premiums will be higher “when inside control of share votes is

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<sup>105</sup> See Holderness, *supra* note 71 at 128; Core, *supra* note 72 at 475.

<sup>106</sup> Core, *supra* note 72 at 475; Griffith, *supra* note 44 at 1174.

<sup>107</sup> See Core, *supra* note 72 at 475; Griffith, *supra* note 44 at 1174.

<sup>108</sup> See Griffith, *supra* note 44 at 1157.

<sup>109</sup> Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 508 (2007).

<sup>110</sup> See *id.* at 508-09.

<sup>111</sup> See Griffith, *supra* note 44 at 1174.

<sup>112</sup> *Id.* at 1150; See also Kyung Tae Lee & Jong Won Choi, *Ki up gi bae gu jo ga Im won bae sang chak im bo hum lyo ye Mi chi noen Yung hyang-Wue bu jun moon ga ye Eui han Gi up gi bae gu jo Pyung ga* [An Outside Assessment of the Corporate Governance Quality: The Directors' and Officers' Insurance Premium], HOE GE HAK EYUN GU JE31KWON JE4HO [ACCT. REV. VOL. 31-4] 79 (2006).

<sup>113</sup> Core, *supra* note 72 at 450.

<sup>114</sup> *Id.*

greater, when inside ownership is lower, when the board is comprised of fewer outside directors, when the CEO has appointed more of the outside directors, and when inside officers have employment contracts.”<sup>115</sup> Such pricing mechanisms theoretically encourage corporations to improve their corporate structures.<sup>116</sup> This is because most corporations want to cut expenses by eliminating factors which negatively affect governance.<sup>117</sup>

However, this mechanism may be problematic since the incentive to improve corporate governance is not great enough.<sup>118</sup> The expenses for improving governance structures may be higher than the saved insurance premiums. Specifically, premiums have a weak influence on the net income of a corporation, whereas governance reform involves the increase of “the costs of regularly reviewing and revising internal governance policies—involving expensive legal and financial advisors as well as the time and attention of the general counsel and top level management.”<sup>119</sup>

Although premiums are not enough to compel corporations to improve their governance, they may function as an indicator of corporate health, which could in turn affect stock price.<sup>120</sup> Investors could take the premium amount into account when determining whether to purchase or sell the corporation’s securities.<sup>121</sup> Ideally, D&O insurance companies directly or indirectly influence corporate structures by pricing insurance premiums based on corporate governance practices.<sup>122</sup>

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<sup>115</sup> *Id.* at 451. On the other hand, Tom Baker and Sean J. Griffith emphasize broader governance factors including “the culture of the firm” and “the character of its management.” Baker & Griffith, *supra* note 109, at 516-27, 538-43.

<sup>116</sup> See Griffith, *supra* note 44, at 1181; See also Lee & Choi, *supra* note 112, at 80.

<sup>117</sup> See Griffith, *supra* note 44, at 1181.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> Baker & Griffith, *supra* note 109, at 536.

<sup>121</sup> See Griffith, *supra* note 44, at 1182-84.

<sup>122</sup> See *id.* at 1180.

Nevertheless, pricing mechanisms can also be problematic because most corporations are unwilling to disclose their insurance premiums.<sup>123</sup> It is extremely disadvantageous for a corporation to be the first to disclose its premium, as it receives no benefit and may be giving D&O policy information to other corporations.<sup>124</sup>

For this reason, Professor Sean Griffith at Fordham Law School suggests reforming securities regulations for mandatory disclosure of D&O insurance information,<sup>125</sup> such as D&O insurance limits, coverage layers, and insurance premiums.<sup>126</sup> Furthermore, the disclosure should include “(1) the amount and structure of a corporation’s insurance coverage, and (2) information on how settlement and defense costs are funded.”<sup>127</sup>

Despite Griffith’s recommendations, it is important to note that in the U.S., mandatory disclosure of D&O insurance information may increase the likelihood of securities lawsuits against innocent insured corporations.<sup>128</sup> The two main types of litigation are securities class action and shareholders derivative action.<sup>129</sup> When a company discloses increased insurance premiums, securities lawsuits may be filed by shareholders who believe that increased premiums tie directly to poor corporate management.<sup>130</sup> However, D&O insurance premiums can increase for various reasons, such as an insurance company’s financial problems, national financial crises, or price fluctuations.

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<sup>123</sup> See *id.* at 1188.

<sup>124</sup> *Id.*

<sup>125</sup> Baker & Griffith, *supra* note 37, at 763, 827.

<sup>126</sup> Griffith, *supra* note 44, at 1150-51, 1203.

<sup>127</sup> Baker & Griffith, *supra* note 37, at 827.

<sup>128</sup> See Tom Oliver Brandi, *The Strike Suit: A Common Problem of The Derivative Suit and The Shareholder Class Action*, 98 DICK. L. REV. 355, 357-59 (1994) (explaining the problem of abusive shareholder litigation in the U.S.).

<sup>129</sup> See *id.* at 357-59.

<sup>130</sup> See Janet Cooper Alexander, *Do The Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 550 (1991) (explaining that settlements in securities class actions do not reflect the merits).

Under Griffith's proposal, insurance details should be disclosed even if the premium increase results from factors unrelated to corporate health.<sup>131</sup> High premiums or increased premiums may lead shareholders to search for a cause of action in corporate governance problems, and to file securities lawsuits.<sup>132</sup> Even if claims are not based upon sufficient grounds, officials are forced to defend themselves in order to prove their innocence. Defending claims is very costly in terms of both time and money.<sup>133</sup> Furthermore, as the defense process continues, the defendant's reputation worsens.<sup>134</sup> In light of these facts, it is easy to see why defendants in securities litigation prefer to settle out of court.<sup>135</sup> As a result, an insurance company covering a corporation or its officials must pay the settlement amounts regardless of liability.<sup>136</sup>

Mandatory disclosure of D&O policy information could exacerbate this problem. Abusive securities litigation burdens both the insured and the insurer.<sup>137</sup> Furthermore, even though some propose the disclosure of these premiums in order to signal information about corporate governance,<sup>138</sup> such governance information is already available through other channels, such as stock price and rating companies' announcements. For this reason, disclosure of D&O insurance policy information would be better left to each company's discretion.

### III. Overview of D&O Liability Insurance in South Korea

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<sup>131</sup> See Baker & Griffith, *supra* note 37, at 827.

<sup>132</sup> See Alexander, *supra* note 130, at 529-57; See also James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903, 905 (1996) (describing opportunistic plaintiff's attorneys in securities litigation); See also Brandi, *supra* note 128, at 368-69.

<sup>133</sup> KNEPPER & BAILEY, *supra* note 47, § 19.10, at 19-29.

<sup>134</sup> See Alexander, *supra* note 130, at 532.

<sup>135</sup> See *id.* at 524.

<sup>136</sup> See *id.* at 556, 561-63.

<sup>137</sup> See *id.* at 561-63; Griffith, *supra* note 44 at 1174; Brandi, *supra* note 128 at 357.

<sup>138</sup> See Griffith, *supra* note 44, at 1203-04.

## A. Versions of D&O Policy

There are two versions of D&O insurance policies in South Korea: a Korean version and an English version.<sup>139</sup> When D&O insurance was first introduced to Korea, only the English version was used.<sup>140</sup> Nevertheless, the English version was not suitable for the Korean legal system because the English policy terms were partly inconsistent with Korean legal terms.<sup>141</sup> Therefore, the Korean version of the D&O policy was developed in 1999.<sup>142</sup> Yet the Korean D&O Policy is not a mere translation of the English version. Rather, the Korean version includes different content from that of the English version.<sup>143</sup> Generally, the Korean version is used only for domestically insured corporations.<sup>144</sup> The English version is used for corporations which need reinsurance by other international insurance companies.<sup>145</sup>

## B. Insured

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<sup>139</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1 (Korean version); HYUNDAI MARINE & FIRE INS., *supra* note 1 (English version).

<sup>140</sup> Seo, *supra* note 26, at 1082.

<sup>141</sup> Eun, *supra* note 9, at 26.

<sup>142</sup> *Id.*

<sup>143</sup> See, e.g., HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1; HYUNDAI MARINE & FIRE INS., *supra* note 1.

<sup>144</sup> Hong, *supra* note 10, at 181.

<sup>145</sup> *Id.*

## 1. Overview

In order to be protected under D&O liability insurance, claims must be brought against an “insured.”<sup>146</sup> Therefore, the definition of “insured” is important in determining whether the D&O policy applies.<sup>147</sup> D&O insurance traditionally covers only the individual directors and officers, and the corporation which indemnifies them.<sup>148</sup> However, some Korean policies provide coverage for the corporation itself in some designated cases, such as securities claims.<sup>149</sup>

## 2. Directors and officers

Both the Korean and English versions of D&O liability insurance cover directors and officers as the insured.<sup>150</sup> In both versions, it is not possible to cover only one particular officer as the insured because all of the officers are jointly liable for damages to the corporation.<sup>151</sup> Thus, insuring a single manager results in protection of the other managers as well.<sup>152</sup>

The Korean version of D&O liability insurance adopts the same definition of directors as the Korean Commercial Act, which states that directors shall be elected at a general

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<sup>146</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, §2; HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1; OLSON ET AL., *supra* note 6, § 12:8, at 12-22.

<sup>147</sup> See OLSON ET AL., *supra* note 6, § 12:8, at 12-22.

<sup>148</sup> See Joseph P. Monteleone, *Directors' and Officers Liability Insurance*, 686 PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES 411, 417 (2007); See also OLSON ET AL., *supra* note 6, §§ 12:20, 12:36; See also KNEPPER & BAILEY, *supra* note 47, § 23.02, at 23-4.

<sup>149</sup> See, e.g., HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 25 (Company Securities Claims (Entity Cover) Clause); HYUNDAI MARINE & FIRE INS., *supra* note 1, at 27 (Company Securities Claims (Entity Cover) Clause).

<sup>150</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 16 (definition); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1.

<sup>151</sup> COMMERCIAL ACT art. 399(1) (S.Korea).

<sup>152</sup> Soo-Young Park, Im won bae sang chaek im ye Kwan han Eyun gu [A Study on the Directors and Officers Liability Insurance] (Sept. 30, 1999) (unpublished Ph.D. dissertation, Chonbuk National University) (on file with author).

shareholders' meeting<sup>153</sup> and that their names and residence numbers shall be registered.<sup>154</sup> The policy also permits individuals who have not undergone this formal process to be insured as long as they are functioning as directors of a company.<sup>155</sup> Therefore, officials who are not officially registered as directors but engage in the day-to-day operations of a business can be covered under D&O insurance.<sup>156</sup> The policy requires all officials to be listed on the policy form.<sup>157</sup> A "director" or an "officer" not only includes current directors and officers, but also retired managers and managers newly appointed during the insured period.<sup>158</sup> A manager who retires before the opening of the first policy period is excluded.<sup>159</sup> If a manager dies, his heirs or legal representatives are considered the insured.<sup>160</sup> In bankruptcy, both a manager and a trustee are considered as one insured entity.<sup>161</sup> Furthermore, directors and officers of a subsidiary company are insured because the Korean version includes coverage for not only the named company but also its subsidiaries.<sup>162</sup>

The English version of D&O insurance is similar to the Korean version in that it provides coverage for "any past, present or future duly elected or appointed directors or officers of the company," and "all new directors and officers during the policy period of this policy."<sup>163</sup> In addition, it covers "the estates, heirs, or legal representatives of deceased directors or officers,"<sup>164</sup> as well as "the legal representatives of directors or officers in the event of their incompetence, insolvency or bankruptcy, who were directors or officers at the time of the

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<sup>153</sup> COMMERCIAL ACT art. 382(1) (S.Korea).

<sup>154</sup> *Id.*

<sup>155</sup> *See* HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 16 (definition).

<sup>156</sup> Park, *supra* note 152, at 135-36.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *See id.*

<sup>163</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 2(c).

<sup>164</sup> *Id.* § 3.

wrongful acts upon which such claims are based were committed.”<sup>165</sup> As a result, unlike the Korean version, the English version protects the estates of deceased officials as insureds.<sup>166</sup> Similarly, in the event of incompetence or insolvency, the legal representatives of such officials are insured.<sup>167</sup> Like the Korean version, the English version covers directors and officers of subsidiaries.<sup>168</sup>

### 3. The corporation

The corporation may also be included within the definition of “insured.”<sup>169</sup> The English version of D&O policy stipulates that two types of coverage be provided for corporations.<sup>170</sup> The first type of coverage reimburses the corporation’s expenditures when the corporation indemnifies its directors and officers.<sup>171</sup> This provision is located in the common policy.<sup>172</sup> The second type of coverage provides entity coverage.<sup>173</sup> It covers losses arising from securities claims made against the company in a separate special clause rather than in the common policy.<sup>174</sup> Thus, this second type of coverage is optional. In order to protect the corporation as a whole under the policy, each party must add the special clause to the common policy.<sup>175</sup>

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<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.* § 2(a).

<sup>169</sup> *See, e.g., id.* § 1; HYUNDAI MARINE & FIRE INS., *supra* note 1, at 27 (Company Securities Claims (Entity Cover) Clause); HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 17 (Company Reimbursement Clause); HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 25 (Company Securities Claims (Entity Cover) Clause).

<sup>170</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 27 (Company Securities Claims (Entity Cover) Clause).

<sup>174</sup> *Id.*

<sup>175</sup> *See, e.g., id.*



The Korean version also provides both company reimbursement coverage and entity coverage.<sup>176</sup> However, as opposed to the English version, the Korean version places both coverage types in special clauses.<sup>177</sup> Therefore, under the Korean version of D&O policy, not only is entity coverage optional but company reimbursement coverage is too.

Thus, in either version of the policy, a corporation may be covered in one of two ways as long as it satisfies the definition of a company.<sup>178</sup> Both versions define “company” as including not only the named corporation but also its subsidiaries.<sup>179</sup> When a company obtains “more than 50% of the total issued and outstanding shares in another corporation,” the former is considered a parent company and the latter is considered its subsidiary.<sup>180</sup> In addition, if a parent company and its subsidiary company have (or if the subsidiary has by itself) stock “more than 50% of the total issued and outstanding shares in another corporation,” that other corporation is also considered a subsidiary company.<sup>181</sup> As a result, in D&O insurance, “company” means the named company and its designated subsidiaries in the policy, as well as any newly created subsidiaries acquired after the effective date of D&O insurance.<sup>182</sup> If a subsidiary company has its own subsidiary, it is also covered under the policy.<sup>183</sup>

### C. Covered Risk

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<sup>176</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 17 (Company Reimbursement Clause); *Id.* at 25 (Company Securities Claims (Entity Cover) Clause).

<sup>177</sup> *See, e.g., id.*

<sup>178</sup> *See* HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 16 (definition); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1.

<sup>179</sup> *Id.* 1.

<sup>180</sup> COMMERCIAL ACT art. 342-2(1) (S.Korea).

<sup>181</sup> *Id.* art. 342-2(3).

<sup>182</sup> *See* Eun, *supra* note 9, at 27.

<sup>183</sup> *Id.*

In order to be protected under D&O insurance, a “claim” must be made during the policy period because Korean D&O insurance is a claims-made insurance.<sup>184</sup> Non-D&O insurance policies are generally based upon occurrence, meaning that the insurer is not obligated to cover loss unless it occurs during the policy period even if claims are made after the policy period.<sup>185</sup> In contrast, D&O insurance operates on a claims-made basis, because it is difficult to place a time period on when directors and officers act and when the damages are established.<sup>186</sup> For this reason, D&O coverage is triggered when claims are first made against directors and officers.<sup>187</sup>

The Korean D&O policy does not define “claim,” which may trigger legal disputes regarding D&O insurance coverage.<sup>188</sup> It is not clear whether “claim” embraces a civil, criminal, administrative, regulatory, or arbitration proceeding for monetary, non-monetary or injunctive relief.<sup>189</sup> In particular, it is questionable whether Korean Financial Supervisory Services investigations are covered as a type of claim. When a regulatory agency such as the Financial Supervisory Service begins investigating directors and officers or a corporation, the proceedings may cause officials or the corporation to incur substantial defense costs.<sup>190</sup> Therefore, disputes may occur concerning whether or not administrative investigations are covered under D&O policy.

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<sup>184</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 2(2); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1; See also OLSON ET AL., *supra* note 6, § 12:7, at 12-18; Jin-Hee Hong, Im won bae sang chaek im bo hum ye Kwan han Eyun gu-Yak kwan eui Hae suk eul Joong sim eu ro [A Study on Directors’ and Officers’ Liability Insurance – With Emphasis on the Construction of Policy] 113 (Aug. 2007) (unpublished Ph.D. dissertation, Chonnam National University).

<sup>185</sup> Hong, *supra* note 184, at 113-15.

<sup>186</sup> *Id.* at 115.

<sup>187</sup> *Id.*

<sup>188</sup> See *id.* at 124.

<sup>189</sup> But see AM. INT’L GROUP (AIG), *supra* note 1, § 2(b).

<sup>190</sup> See Matthew L. Jacobs & Kristina Filipovich, *Director and Officer Liability Coverage – The Basics*, 774 PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES 137, 154 (2008) (describing loss arising from SEC investigation).

In addition, under the Korean D&O policy, the insured should notify the insurer shortly after claims are brought against the insured.<sup>191</sup> The notice generally includes the allegation, “the names of claimants and the manner in which the insureds first became aware of the claim.”<sup>192</sup> The notification requirement is considered to be satisfied when the notice is mailed.<sup>193</sup>

#### **D. Coverage**

In order to be protected under D&O insurance, the insured should have “losses” as a D&O policy typically provides coverage only for losses arising from claims made against insureds.<sup>194</sup> “Loss”, as covered in the English version of the D&O policy, includes damages, judgments, settlements and defense costs.<sup>195</sup> This section stipulates that the term “loss” excludes “civil or criminal fines or penalties imposed by law, punitive or exemplary damages, the multiplied portion of multiplied damages, [and] taxes,”<sup>196</sup> as well as “any amount for which the insureds are not financially liable or which are without legal recourse to the insureds, or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.”<sup>197</sup>

Under the Korean version of the D&O policy, “loss” includes legal damages and defense costs.<sup>198</sup> It does not explicitly mention judgments or settlements, which creates difficulties in

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<sup>191</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 18; HYUNDAI MARINE & FIRE INS., *supra* note 1, § 8.

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 2(1), (2); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1; OLSON ET AL., *supra* note 6, § 12:10, at 12-26.

<sup>195</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 2(d).

<sup>196</sup> *Id.* § 2(d).

<sup>197</sup> *Id.*

<sup>198</sup> *Id.* § 5.

interpreting the scope of the damages.<sup>199</sup> However, “legal damages” in the Korean version is considered to include judgments because the purpose of D&O insurance is to cover loss arising from claims, and judgments are the typical results of such claims. Furthermore, “legal damages” may include settlements because admitting or assuming liability for damages entails settling.<sup>200</sup> The Korean version of the policy allows the insured to admit liability for damages with the prior written consent of the insurer.<sup>201</sup> However, in the Korean version, “loss” does not cover taxes, penalties, fines, punitive or exemplary damages, the multiplied portion of multiplied damages, or damages increased on an agreement.<sup>202</sup> Unlike the English version, it excludes damages increased on an agreement, and it does not exclude “any amount for which the insureds are not financially liable or which are without legal recourse to the insureds, or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.”<sup>203</sup>

## E. Exclusion

In order to be protected under D&O insurance, a claim should not fall under any exclusion in the policy.<sup>204</sup> Both the Korean and English versions of D&O policy contain exclusions.

The English version of D&O policy stipulates that the insurer shall not be liable to cover loss if claims are involved in (a) personal profit or advantage,<sup>205</sup> (b) dishonest or criminal acts,<sup>206</sup>

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<sup>199</sup> *Id.*

<sup>200</sup> Hong, *supra* note 184, at 143.

<sup>201</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(3).

<sup>202</sup> *See id.* at 16 (definition).

<sup>203</sup> *Id.*

<sup>204</sup> *See* OLSON ET AL., *supra* note 6, § 12:11, at 12-30.

<sup>205</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 4(a).

<sup>206</sup> *Id.* § 4(b).

(c) return of remuneration without shareholders' approval,<sup>207</sup> (d) insider trading profits,<sup>208</sup> (e) commissions, political payments, and gratuities,<sup>209</sup> (f) prior acts, or prior or pending litigation,<sup>210</sup> (g) discharge, dispersal, release or escape of pollutants,<sup>211</sup> (h) directorship or officership for any other entity,<sup>212</sup> (i) nuclear material,<sup>213</sup> (j) bodily injury, emotional injury, property damages, and personal injury,<sup>214</sup> (k) subsidiary officers' or directors' wrongful acts occurring at any time when the subsidiary requirement is not satisfied,<sup>215</sup> and (l) derivative action.<sup>216</sup> Moreover, the English version of the D&O policy has special exclusion clauses including the Punitive Damage Exclusion Clause, Nuclear Energy Liability Exclusion Clause, Prior Acts Exclusion Clause, Failure to Maintain Insurance Exclusion Clause, Captive Insurance Company Exclusion Clause, Regulatory Exclusion Clause, SEC Exclusion Clause, ERISA Exclusion Clause, Year 2000 Exclusion Clause, Professional Services Liability Exclusion Clause, Insured v. Insured Exclusion Clause, Closely-Held Clause, Financial Institution Clause, and Bankruptcy Exclusion.<sup>217</sup>

The Korean version of the D&O policy stipulates that the insurer shall not be liable to cover loss if claims are involved in (a) personal profit or advantage,<sup>218</sup> (b) dishonest or criminal acts,<sup>219</sup> (c) return of remuneration without shareholders' approval,<sup>220</sup> (d) insider trading profits,<sup>221</sup>

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<sup>207</sup> *Id.* § 4(c).

<sup>208</sup> *Id.* § 4(d).

<sup>209</sup> *Id.* § 4(f).

<sup>210</sup> *Id.* § 4(f), (g), (h).

<sup>211</sup> *Id.* § 4(i).

<sup>212</sup> *Id.* § 4(j) (excluding claims arising from "any act or omission in their capacities as directors or officers of any other entity other than the Company, or by reason of their status as a director or officer of such other entity").

<sup>213</sup> *Id.* § 4(k).

<sup>214</sup> *Id.* § 4(l).

<sup>215</sup> *Id.* § 4(m).

<sup>216</sup> *Id.* § 4(n).

<sup>217</sup> *Id.* at 13-38.

<sup>218</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 7(1).

<sup>219</sup> *Id.* § 7(2)(3).

<sup>220</sup> *Id.* § 7(4).

<sup>221</sup> *Id.* § 7(5).

(e) commissions, political payments, and gratuities,<sup>222</sup> (f) prior acts, or prior or pending litigation,<sup>223</sup> (g) discharge, dispersal, release or escape of pollutants,<sup>224</sup> (h) nuclear material,<sup>225</sup> (i) bodily injury, emotional injury, property damages, and personal injury,<sup>226</sup> (j) subsidiary officers' or directors' wrongful acts occurring at any time when the subsidiary requirement is not satisfied,<sup>227</sup> (k) insured v. insured,<sup>228</sup> (l) closely-held clause,<sup>229</sup> (m) directorship or officership for any other entity,<sup>230</sup> (n) derivative action.<sup>231</sup> Moreover, it has special exclusion clauses including the Employment Retirement Income Security Act exclusion, the Regulatory Exclusion Clause, the Year 2000 Exclusion Clause, the Financial Institution Clause, the Failure to Maintain Insurance Exclusion clause, and the Securities and Exchange Act Exclusion.<sup>232</sup>

## **IV. Comparison of U.S. and South Korean D&O Liability Insurance**

### **A. Purchasing Insurance**

The Model Business Corporation Act (“MBCA”) and Delaware G.C.L. permit a corporation to purchase and maintain D&O insurance for directors and officers notwithstanding a corporation’s ability to indemnify.<sup>233</sup> In most U.S. jurisdictions, therefore, a corporation can

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<sup>222</sup> *Id.* § 7(6).

<sup>223</sup> *Id.* § 8(5).

<sup>224</sup> *Id.*

<sup>225</sup> *Id.* § 8(6).

<sup>226</sup> *Id.* § 8(7).

<sup>227</sup> *Id.* § 8(8).

<sup>228</sup> *Id.* § 8(9).

<sup>229</sup> *Id.* § 8(10).

<sup>230</sup> *Id.* § 8(11) (excluding claims against any act while serving as a director or an officer of a different corporation).

<sup>231</sup> *Id.* § 9.

<sup>232</sup> *Id.* at 17-32.

<sup>233</sup> MODEL BUS. CORP. ACT § 8.57 (2008); DEL. CODE ANN. tit. 8, § 145(g) (2001).

legally provide insurance for directors and officers.<sup>234</sup> Moreover, under the Delaware G.C.L., the board of directors is entitled to determine the compensation for directors.<sup>235</sup> Thus, in the U.S., the board of directors can commit to paying D&O insurance premiums, even if the payments become part of the compensation.<sup>236</sup>

The Korean Commercial Act does not provide any standards for D&O insurance.<sup>237</sup> Thus, the legal theory in this area is not sufficient, and many problems remain unresolved. One of the controversial issues is whether or not a corporation has the right to purchase such insurance on behalf of directors and officers.<sup>238</sup>

Some argue that a corporation should be allowed to purchase D&O insurance on behalf of the directors and officers<sup>239</sup> in order to guarantee reimbursement of any losses accrued on behalf of the corporation.<sup>240</sup> This policy of reimbursement benefits the entire corporate entity<sup>241</sup> and allows directors and officers to work more actively for the corporation.<sup>242</sup> Furthermore, some argue that the Korean Enforcement Decree of the Income Tax Act indirectly permits a corporation to buy insurance for its officials by excluding D&O insurance premiums from the income tax list.<sup>243</sup>

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<sup>234</sup> See KNEPPER & BAILEY, *supra* note 47, § 23.03, at 23-6.

<sup>235</sup> DEL. CODE ANN. tit. 8, § 141(h).

<sup>236</sup> Park, *supra* note 152, at 155.

<sup>237</sup> Black et al., *supra* note 11, at 85.

<sup>238</sup> See Park, *supra* note 31, at 146.

<sup>239</sup> See Young Sun Kim, *Jun moon jik up in bae sang chaek im bo hum* [Professional Liability Insurance], SANG SA BUB EYUN GU JE18KWON JE2HO [COM. L. REV. VOL.18-2] 239 (1998).

<sup>240</sup> See *id.*

<sup>241</sup> See *id.*

<sup>242</sup> See Park, *supra* note 152, at 153.

<sup>243</sup> See ENFORCEMENT DECREE OF THE INCOME TAX ACT, art. 38(1)12(e) (S.Korea) (stipulating that “the following insurance premiums...shall be excluded:...Insurance premium of an insurance whose insured is an officer or employee, and whose ground for payment is the compensation for the damage incurred by an act in the course of duties....” from the scope of the earned income); Sun Jung Kim, *Im won bae sang chaek im bo hum Hwal sung hwa eui Bub juk Kwa je* [Legal Issues concerning the Activities of D&O Insurance], BO HUM GAE BAL EYUN GU JE11KWON JE3HO [KOREA INS. DEV. STUD. VOL. 11-3] 3, 23 (2000).

Others argue that a corporation should not pay D&O insurance premiums on the grounds that such expenses cause a loss to the corporation, and thus, the decision to pay those premiums violates the fiduciary duty of the directors.<sup>244</sup> Moreover, it is often argued that free D&O coverage encourages managers to be imprudent in their business judgment because they are then free to rely on the insurance policy to cover their mistakes.<sup>245</sup> Thus, the U.S. concern about moral hazard is likewise present in Korea.

Furthermore, corporate funding for D&O insurance may violate the Korean Commercial Act, which requires consent from all shareholders in order to dismiss managers from responsibility.<sup>246</sup> The Korean Commercial Act stipulates that directors are liable for the loss to their corporation when they neglect their duty or violate laws or by-laws.<sup>247</sup> In order to discharge such directors from liability, the entirety of the company's shareholders must consent to the exemption.<sup>248</sup> If a corporation purchases D&O insurance for its officials, the corporation, in effect, renounces any future claims against officials.<sup>249</sup> Purchasing the insurance policy without any consent indirectly violates the Korean Commercial Act Article 400.<sup>250</sup>

Of the two arguments presented above, the former appears to be more persuasive because it accurately reflects the corporate world. A corporation needs to pay insurance premiums in order to attract qualified officials. Such insurance coverage is not only advantageous for officials, but also for the entire corporate entity. Second, there is no violation of Article 400 of the Korean Commercial Act even if a corporation purchases the insurance without consent of its

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<sup>244</sup> See Park, *supra* note 31, at 147.

<sup>245</sup> See *id.*

<sup>246</sup> COMMERCIAL ACT art. 400 (S.Korea) (stipulating that “[t]he liability of directors under Article 399 may be released by the consent of all shareholders.”); Bok Ki Hong, *Mi gook hoi sa bub ye It u su Ee sa chaek im eui Gu je je do* [*The Remedy for Director's Liability in the American Corporate Law*], BUB RUL YON GU JE4JIB [YONSEI L. REV. VOL.4] 227, 266 (1985); Park, *supra* note 31, at 147; Park, *supra* note 152, at 150-51.

<sup>247</sup> COMMERCIAL ACT art. 399 (S.Korea).

<sup>248</sup> *Id.* art. 400.

<sup>249</sup> See Hong, *supra* note 246, at 266; Park, *supra* note 31, at 147; Park, *supra* note 152, at 150-51.

<sup>250</sup> COMMERCIAL ACT art. 400 (S.Korea).



shareholders, as exemption from liability is distinguished from payment when liability is established.<sup>251</sup> Therefore, although it is necessary to limit the potential abuse of corporate expenses for D&O insurance, the requirement under Article 400 does not apply in the purchase of insurance policies. Instead, the concept of compensation, which includes basic salary, incentives, and life insurance premiums, could be considered.<sup>252</sup> Similar to life insurance premiums, D&O insurance premiums would also be considered as part of an official's compensation.<sup>253</sup> Thus, Article 388 of the Korean Commercial Act (as opposed to Article 400) applies to insurance premiums.<sup>254</sup> As a result, a corporation can legally purchase the insurance for its directors and officers if the insurance premium funding is approved by “affirmative votes of a majority of the voting rights of shareholders present thereat and representing at least 1/4 of the total issued and outstanding shares” in a shareholder's meeting.<sup>255</sup>

## **B. The Scope of Coverage**

### **1. Defense Obligation**

Controversy exists concerning the defense of litigation in D&O coverage.<sup>256</sup> The first and most basic issue is whether the insurers have an obligation to defend in securities

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<sup>251</sup> See COMMERCIAL ACT art. 400 (S.Korea).

<sup>252</sup> Park, *supra* note 152, at 151.

<sup>253</sup> *Id.* at 153.

<sup>254</sup> COMMERCIAL ACT art. 388 (S.Korea) (stipulating that “[i]f the amount of remuneration to be received by directors has not been fixed by the articles of incorporation, it shall be determined by the resolution at a general shareholders' meeting.”).

<sup>255</sup> See *id.* art. 388, 368 (S.Korea).

<sup>256</sup> See OLSON ET AL., *supra* note 6, § 12:22.

litigation.<sup>257</sup> The second issue is whether the insurance covers defense costs.<sup>258</sup> If so, the last crucial issue becomes whether defense costs are advanced.<sup>259</sup>

Because corporations and managers want to control the defense process, such as choice of counsel and settlement,<sup>260</sup> the typical U.S. D&O insurance policy provides that the insurer is not subject to any defense obligation.<sup>261</sup> For similar reasons, the Korean D&O policy also refuses to impose a duty to defend upon the insurer.<sup>262</sup>

Generally, instead of a duty to defend, the insurer has a duty to pay.<sup>263</sup> Exactly when such costs should be paid is a significant issue that must be outlined in the insurance agreement.<sup>264</sup> Requiring insurance companies to advance defense costs is often beneficial.<sup>265</sup> The insurance company may incur huge financial losses when directors and officers cannot afford to defend themselves and thus fail in their defense.<sup>266</sup> Because of such risks, U.S. D&O policies began to provide the option to advance defense costs in each case.<sup>267</sup> For example, the insurance policy in *Okada v. MGIC Indemnity Corp* stated that “[t]he Insurer may at its option and upon request, advance...expenses which they have incurred in connection with claims made against them, prior to disposition of such claim[s]....”<sup>268</sup>

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<sup>257</sup> *Id.* § 12:23.

<sup>258</sup> KNEPPER & BAILEY, *supra* note 47, § 24.15.

<sup>259</sup> Matthew L. Jacobs & Erika Kane, *Basic Principles of Professional Liability Insurance*, PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES, PLI ORDER NO. 11214, 129, 151 (2007).

<sup>260</sup> *See* MATHIAS ET AL., *supra* note 37, § 9.04, at 9-11; OLSON ET AL., *supra* note 6, § 12:23, at 12-52.

<sup>261</sup> *See, e.g.*, AM. INT’L GROUP (AIG), *supra* note 1, § 8; CHUBB CORP., *supra* note 66, § 1(A).

<sup>262</sup> *See* HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(2); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>263</sup> OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>264</sup> Jacobs & Kane, *supra* note 259, at 152.

<sup>265</sup> *See* OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>266</sup> *See id.*

<sup>267</sup> *Id.*

<sup>268</sup> *Okada v. MGIC Indem. Corp.*, 823 F.2d 276, 279 (9th Cir. 1986).

This option to advance costs is problematic because it places the insurer as the holder of the option.<sup>269</sup> In *Okada*, the Ninth Circuit Court of Appeals resolved the issue regarding the option to advance defense costs by interpreting the policy terms in favor of the insured.<sup>270</sup> The court found that legal defense costs should be paid contemporaneously unless the policy obviously provides for the exclusion.<sup>271</sup> Therefore, the insurer should pay defense costs as they are incurred when the policy terms are vague and the insured could reasonably believe that the insurer would pay attorney fees contemporaneously.<sup>272</sup>

In *Okada*, the plaintiffs argued that the defendant should pay defense costs concurrently on the grounds that the costs were covered under the policy.<sup>273</sup> However, the defendant countered that the D&O policy did not guarantee contemporaneous payment of litigation expenses<sup>274</sup> because the policy terms provided that the insurer would pay defense costs immediately only when the insured obtained the insurer's approval to such coverage.<sup>275</sup> The court held that the insurer should pay defense costs as they were incurred when the insured could reasonably believe they would receive contemporaneous payment of litigation expenses and the policy did not mention otherwise.<sup>276</sup> This holding is based upon the general insurance principle that policy terms should be construed in favor of the insured when the terms are vague.<sup>277</sup>

*Okada* had a significant influence on the U.S. insurance market.<sup>278</sup> After *Okada*, a number of D&O policies started to explicitly state that defense costs could not be advanced or

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<sup>269</sup> See *id.* at 276; OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>270</sup> *Okada*, 823 F.2d 276.

<sup>271</sup> *Id.*

<sup>272</sup> See *id.*

<sup>273</sup> *Okada v. MGIC Indem. Corp.*, 608 F.Supp. 383, 385 (D. Haw. 1985), *aff'd*, 823 F.2d 276 (9th Cir. 1986).

<sup>274</sup> *Okada*, 823 F.2d at 281.

<sup>275</sup> *Id.* at 824.

<sup>276</sup> *Id.* at 276.

<sup>277</sup> See *id.* at 284.

<sup>278</sup> See OLSON ET AL., *supra* note 6, § 12:25, at 12-58 to -59.

that the insured had the right to choose to receive defense costs in advance.<sup>279</sup> Ultimately, the policies provided that defense costs be advanced automatically if the insured corporation could not assume the defense costs.<sup>280</sup> Furthermore, most current D&O policies advance defense costs whether or not an insured corporation pays the expenses:<sup>281</sup> “...the Insurer shall advance...covered Defense Costs no later than ninety (90) days after the receipt by the Insurer of such defense bills.”<sup>282</sup>

Similar to the practice in the U.S., Korean D&O coverage generally entails defense costs under the Korean Commercial Act.<sup>283</sup> The Act stipulates that liability insurance covers defense costs.<sup>284</sup> However, the Act does not provide for exactly when defense costs are to be paid, and thus the timing of payment depends upon the terms of each policy.<sup>285</sup> Korean D&O policy provides that the insurance company “may” advance defense costs and that there is “no duty to reimburse defense costs prior to the final disposition of the claim.”<sup>286</sup> Therefore, the timing of the advance is fully dependent upon the discretion of the insurer.<sup>287</sup> If the insurer refuses to advance the expenses, the directors and officers have to defend the lawsuit at their own expense.<sup>288</sup>

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<sup>279</sup> *Id.*

<sup>280</sup> *Id.* § 12:25, at 12-59.

<sup>281</sup> *See id.*

<sup>282</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 8.

<sup>283</sup> COMMERCIAL ACT art. 720(1) (S.Korea).

<sup>284</sup> *Id.*

<sup>285</sup> The Korean Commercial Act art. 720(1) does not require the insurer to advance defense costs by merely stating that “the insured may demand from the insurer an advance payment of [defense] expenses. Therefore, whether or not defense costs are advanced is left to the discretion of the insurer. PARK, *supra* note 152, at 179.

<sup>286</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(1); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>287</sup> Jin-Hee Hong, *Im won bae sang chaek im bo hum eui Bang u bi yong kwa Hwa hae geum [Defense Cost and Settlement Sums in the Directors and Officers Liability Policy]*, KI UP BUB EYUN GU JE22KWON JE1HO(TONG KWON JE32HO) [BUS. L. VOL.22-1(32)] 93 (2008).

<sup>288</sup> *See id.*

Current Korean D&O coverage raises issues similar to those in *Okada*<sup>289</sup> because Korean insurance companies desire to be in the more favorable position.<sup>290</sup> For example, a multinational insurance company, such as the American Home Assurance Company Korea,<sup>291</sup> takes the advantage by using a different policy form in Korea.<sup>292</sup> The policy used in Korea gives the insurer the option to advance defense costs, whereas the common practice now in the U.S. is to provide automatic advancement of defense costs.<sup>293</sup>

## 2. Settlement

Settlement is a significant issue arising in D&O insurance because most securities lawsuits are settled before adjudication.<sup>294</sup> Generally, U.S. D&O policy provides coverage for settlement as part of a loss.<sup>295</sup> The English version of Korean D&O policy also clearly states that it covers settlements.<sup>296</sup> However, the Korean version merely provides for legal damages and defense costs, and does not mention settlement sums.<sup>297</sup> The question then becomes whether the legal damages include judgment as well as settlement sums under the Korean version of D&O

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<sup>289</sup> See *Okada v. MGIC Indem. Corp.*, 608 F.Supp. 383, 385 (D. Haw. 1985), *aff'd*, 823 F.2d 276 (9th Cir. 1986).

<sup>290</sup> See *id.* at 276; OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>291</sup> American Home Assurance Company Korea is an affiliated company of Chartis (formerly AIG). American Home Assurance Company Korea, <http://www.chartis.co.kr> (last visited April 13, 2010).

<sup>292</sup> AM. HOME ASSURANCE COMPANY KOREA, DIRECTORS AND OFFICERS LIABILITY AND COMPANY REIMBURSEMENT POLICY, [http://www.1root.net/insurance/product/CHARTIS\\_.pdf](http://www.1root.net/insurance/product/CHARTIS_.pdf) (last visited April 13, 2010).

<sup>293</sup> Compare AM. HOME ASSURANCE COMPANY KOREA, *supra* note 292, § 8 (“...the Insurer may...advance Defense Costs prior to the final disposition of the claim...”), with AM. INT’L GROUP (AIG), *supra* note 1, § 8 (“...the Insurer shall advance...covered Defense Costs no later than ninety (90) days after the receipt by the Insurer of such defense bills.”).

<sup>294</sup> Baker & Griffith, *supra* note 37, at 802.

<sup>295</sup> See, e.g., AM. INT’L GROUP (AIG), *supra* note 1, § 2; CHUBB CORP., *supra* note 66, § 1(A).

<sup>296</sup> See HYUNDAI MARINE & FIRE INS., *supra* note 1, § 2.

<sup>297</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 5.

policy.<sup>298</sup> In Korea, D&O professionals, making inferences from other provisions that allow the insured to admit liability for damages with the prior written consent of the insurer,<sup>299</sup> consider settlements to be covered under the current policy.<sup>300</sup> However, in order to protect the insured, specifications regarding settlement costs need to be added to the Korean version's coverage provisions.

The typical U.S. D&O policy also requires that the insured obtain the insurer's written consent prior to settlement.<sup>301</sup> The purpose of the consent is to protect an insurer from a conspiracy between parties or lawyers, which could disadvantage the insurers.<sup>302</sup> In order to prevent ethical violations, Korean D&O policies also provide a consent requirement.<sup>303</sup> Such a requirement protects the insurer from having to pay uncovered claims.<sup>304</sup> If the insured settles without the insurer's consent, the insurance company does not have to cover the losses.<sup>305</sup>

It is questionable exactly when this "prior" approval must be obtained.<sup>306</sup> In *Caterpillar, Inc. v. Great American Insurance Co.*, the court found that consent was required before settling a claim, but not before a settlement was offered.<sup>307</sup> In that case, the plaintiff argued that the insurer should cover the entire settlement amount under the D&O policy.<sup>308</sup> However, the

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<sup>298</sup> See Hong, *supra* note 287, at 95.

<sup>299</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(3).

<sup>300</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 5; Gun-Sik Kim & Moon-Hee Choi, *Ee sa eui Bae sang chaek im bo hum-Im won bae sang chaek im bo hum Yak kwan eui Myun chaek sa you roel Joong sim eu ro* [Directors' and Officers' Liability Insurance – Focusing Exclusions in D&O policy], SANG JANG HYUB EYUN GU JE45HO [KOREA LISTED COMPANIES ASS'N RES. VOL.45] 123, 127 (2002).

<sup>301</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 8; CHUBB CORP., *supra* note 66, § 10.

<sup>302</sup> See OLSON ET AL., *supra* note 6, § 12:27, at 12-66; *but see* Baker & Griffith, *supra* note 37, at 799, 806-07.

<sup>303</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 19(1); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>304</sup> See Baker & Griffith, *supra* note 37, at 798.

<sup>305</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 19(1); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>306</sup> See *Caterpillar, Inc. v. Great American Ins. Co.*, 864 F.Supp. 849, 858 (C.D. Ill. 1994), *aff'd*, 62 F.3d 955 (7th Cir. 1995).

<sup>307</sup> *Id.* at 860.

<sup>308</sup> *Caterpillar, Inc. v. Great American Ins. Co.*, 62 F.3d 955, 959 (7th Cir. 1995).

defendant countered that the insured violated the policy terms by making a settlement offer without the insurer's consent, and thus the insured was no longer entitled to reimbursement for the settlement.<sup>309</sup> Furthermore, the insurer contended that the settlement offer was unreasonably high.<sup>310</sup> The court found that the insured was not required to receive the insurer's consent prior to the offer of settlement.<sup>311</sup> The D&O policy only compelled the insured to obtain the insurer's consent before the final settlement.<sup>312</sup>

Prior consent from the insurer is designed to prevent collusion between parties or lawyers.<sup>313</sup> However, it is questionable whether the consent requirement achieves this goal as, under U.S. D&O policy, the insurer cannot withhold consent without reasonable grounds.<sup>314</sup> If the company fails to offer consent for a settlement, it is possible that it "could be liable for the entire judgment that results, not just the limits of the D&O insurance policy."<sup>315</sup>

The English version of Korean D&O policy also provides that "The Insurer's consent shall not be unreasonably withheld..."<sup>316</sup> However, the Korean version does not provide for such limits to consent.<sup>317</sup> This gives an unreasonably advantageous position to an insurance company when claims occur.

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<sup>309</sup> *Caterpillar, Inc.*, 864 F.Supp. at 857-58.

<sup>310</sup> *Id.*

<sup>311</sup> *Caterpillar, Inc.*, 62 F.3d at 965.

<sup>312</sup> *Id.*

<sup>313</sup> See Baker & Griffith, *supra* note 37, at 798, 806-07; See also MARTIN O'LEARY, DIRECTORS & OFFICERS LIABILITY INSURANCE DESKBOOK 157 (ABA Publishing 2nd ed. 2006).

<sup>314</sup> See AM. INT'L GROUP (AIG), *supra* note 1, § 8; Baker & Griffith, *supra* note 37, at 799.

<sup>315</sup> Baker & Griffith, *supra* note 37, at 799.

<sup>316</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>317</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, §§ 19-20.

### 3. Allocation

The purpose of D&O insurance is to cover either the loss of individual directors and officers when they are not indemnified by their corporation, or the loss of a corporation that indemnifies its directors and officers.<sup>318</sup> D&O insurance does not aim to protect a corporation itself from the loss caused by claims made against the entity in principle.<sup>319</sup> Therefore, an insurance company can claim allocation between covered officers and the uncovered entity.<sup>320</sup> As a result, even if directors and officers procure losses arising from claims covered under the policy, they sometimes face an unexpected decrease in D&O coverage.<sup>321</sup> Such curtailment of coverage is caused in part by allocations between covered and uncovered parties or matters.<sup>322</sup>

Two common law standards exist concerning the allocation of settlement sums.<sup>323</sup> The first standard is the rule of relative exposure.<sup>324</sup> This rule was adopted in *Pepsi Company Incorporated v. Continental Casualty Company*, which required that relative faults should be assessed when allocating the settlement amount.<sup>325</sup>

In this case, the insured, PepsiCo, contended that the insurer, Continental, should cover the entire sum of the settlement because the directors and officers were solely liable and covered by Continental.<sup>326</sup> Although Continental agreed to the settlement, it rebutted that it was not obligated to cover the full amount.<sup>327</sup> Continental claimed that the settlement should be allocated

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<sup>318</sup> O'LEARY, *supra* note 313, at 169.

<sup>319</sup> *Id.*

<sup>320</sup> See Jacobs & Kane, *supra* note 2599, at 152.

<sup>321</sup> MATHIAS ET AL., *supra* note 37, § 6.04[1]; Jacobs & Kane, *supra* note 259, at 152.

<sup>322</sup> See Jacobs & Kane, *supra* note 2599, at 152.

<sup>323</sup> *Id.* at 152-53.

<sup>324</sup> MATHIAS ET AL., *supra* note 37, § 6.04[3], at 6-44.

<sup>325</sup> See *PepsiCo, Inc. v. Cont'l Cas. Co.*, 640 F.Supp. 656, 662 (S.D.N.Y. 1986); MATHIAS ET AL., *supra* note 37, § 6.04[3], at 6-44.

<sup>326</sup> *PepsiCo, Inc.*, 640 F.Supp. at 661.

<sup>327</sup> *Id.*



to each defendant because the policy states that “it covers only the directors and officers of PepsiCo, not the corporation and not its accounting firm.”<sup>328</sup> The court found that Continental was entitled to “allocate the settlement costs between those amounts attributable to the directors and officers and those attributable to PepsiCo and its accountants.”<sup>329</sup>

However, under the relative exposure rule, the allocation all too often turns on subjective standards.<sup>330</sup> Thus, some courts have followed an alternative rule: the larger settlement rule.<sup>331</sup>

The larger settlement rule, first adopted in *Harbor Insurance Co. v. Continental Bank Corp.*, states that the insurer is obligated only to pay the portion of the settlement caused by an insured person.<sup>332</sup> In this case, the court held that the insurer was entitled to an allocation of the settlement only when the wrongful act of an uninsured party increased the settlement amount.<sup>333</sup> The trial court found that the entire settlement amount should be allocated to Continental.<sup>334</sup> However, the Seventh Circuit Court of Appeals reversed the decision by holding that the entire settlement amount should be allocated to the directors.<sup>335</sup> According to the Seventh Circuit, the insurers were obligated to reimburse the insured for the settlement, excluding the portion of the settlement caused by an uninsured person.<sup>336</sup> Furthermore, the court found that allocating the settlement “between the directors’ liability and the corporation’s derivative liability for directors’ act”<sup>337</sup> impedes the function of D&O insurance and makes it meaningless.<sup>338</sup>

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<sup>328</sup> *Id.*

<sup>329</sup> *Id.* at 662.

<sup>330</sup> *See Caterpillar, Inc. v. Great American Ins. Co.*, 62 F.3d 955, 959 (7th Cir. 1995).

<sup>331</sup> *See id.*; Jacobs & Kane, *supra* note 259, at 152-54.

<sup>332</sup> *See Harbor Ins. Co. v. Cont’l Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990); *See also* MATHIAS ET AL., *supra* note 37, § 6.04[3], at 6-46.

<sup>333</sup> *Harbor Ins. Co.*, 922 F.2d at 357.

<sup>334</sup> *Id.* at 359-60.

<sup>335</sup> *Id.* at 357.

<sup>336</sup> *Id.* at 367-68.

<sup>337</sup> *Id.* at 368.

<sup>338</sup> *Id.*

After *Harbor*, the court adopted this rule in *Caterpillar* as well.<sup>339</sup> The *Caterpillar* court followed the reasoning of *Harbor*, based on the larger settlement rule.<sup>340</sup> According to the court's decision, the insurer could allocate the settlement and "[t]hat allocation may only reflect the extent to which the settlement was larger because of claims against uninsured persons or the actions of persons against whom no claims were made."<sup>341</sup>

Most modern U.S. D&O policies provide allocation standards in order to avoid the above-mentioned legal disputes.<sup>342</sup> American International Group ("AIG") D&O policy stipulates that "[parties]...agree to use their best efforts to determine a fair and proper allocation of the amounts...taking into account the relative legal and financial exposures, and the relative benefits obtained by any such Insured and any such Organization."<sup>343</sup> Chubb D&O policy provides for an arbitration process in allocation disputes.<sup>344</sup> However, these provisions still contain many opportunities for legal disputes in allocation because they depend largely upon subjective matters and negotiations between parties.<sup>345</sup> Therefore, some insurers provide entity coverage provisions or pre-determined allocation provisions, in order to reduce the possibility of disputes regarding allocation in advance.<sup>346</sup>

Korean D&O policy also states that parties should cooperate for fair and proper allocation but does not indicate any specific allocation method.<sup>347</sup> The "fair and proper"

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<sup>339</sup> See *Caterpillar, Inc. v. Great American Ins. Co.*, 62 F.3d 955, 959 (7th Cir. 1995).

<sup>340</sup> See *id.* at 959-64.

<sup>341</sup> *Id.* at 964.

<sup>342</sup> See MATHIAS ET AL., *supra* note 37, § 6.04[4], at 6-48 to -49.

<sup>343</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 8.

<sup>344</sup> See CHUBB CORP., *supra* note 66, § 11(B).

<sup>345</sup> See Joseph P. Monteleone & Nicholas J. Conca, *Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues*, 51 BUS. LAW. 573, 608 (1996).

<sup>346</sup> Joseph P. Monteleone, *Resolving Continuing Allocation Challenges in D&O Liability Coverage*, 563 PRACTISING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES 29, 42-46 (1997).

<sup>347</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(4); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

standard is extremely vague.<sup>348</sup> Thus, the allocation process often faces the same problems with subjectivity and negotiation as the AIG and Chubb D&O policies.<sup>349</sup> Therefore, Korean D&O policy needs to provide more specific standards for allocation.

### C. Insured v. Insured Exclusion

A typical U.S. D&O policy contains an insured v. insured exclusion.<sup>350</sup> This exclusion precludes coverage for claims made by a corporation against insured officials or by an insured official against another insured official.<sup>351</sup> Under this exclusion, a corporation is not allowed to transfer loss arising from management mistakes to a D&O insurance company by bringing an action against insured directors and officers.<sup>352</sup> Therefore, the corporation cannot collect the insurance in order to ease a shortage of cash.<sup>353</sup>

Korean D&O policy also contains an insured v. insured exclusion.<sup>354</sup> The English version precludes “any claim made against the insureds which is brought by any insured or the subsidiary or affiliate of the company, or any security holder(s) of any of the above entities...”<sup>355</sup>

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<sup>348</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(4); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9; Hong, *supra* note 287, at 102.

<sup>349</sup> See Monteleone & Conca, *supra* note 345, at 608.

<sup>350</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 4(i); KNEPPER & BAILEY, *supra* note 47, § 25.08, at 25-17.

<sup>351</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 4(i); OLSON ET AL., *supra* note 6, § 12:14, at 12-36.

<sup>352</sup> See OLSON ET AL., *supra* note 6, § 12:14, at 12-36.

<sup>353</sup> See *Township of Ctr., Butler Co., Pa. v. First Mercury Syndicate, Inc.*, 117 F.3d 115, 119 (3d Cir. 1997) (explaining that the purpose of the insured v. insured exclusion is “to prevent collusive suits in which an insured company might seek to force its insurer to pay for the poor business decisions of its officers or managers.”); KNEPPER & BAILEY, *supra* note 47, § 25.08, at 25-19.

<sup>354</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 8(9); HYUNDAI MARINE & FIRE INS., *supra* note 1, at 32 (Insured vs. Insured Exclusion Clause).

<sup>355</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, at 32 (Insured vs. Insured Exclusion Clause).

This provision is located in a separate special clause.<sup>356</sup> However, the Korean version places the insured v. insured exclusion within the common policy.<sup>357</sup>

In addition, U.S. D&O policy does not allow this exclusion to apply when “such [a] security holder’s or member’s Claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Executive of an Organization or any Organization.”<sup>358</sup> However, Korean D&O policy does not state this exception to the exclusion.<sup>359</sup>

## **V. Recommendations for the Reform of the Korean D&O Liability Insurance System**

### **A. Reconsideration of Mandatory Disclosure of D&O Insurance Information**

Chapter II of this paper revealed that the U.S. does not require a corporation to disclose D&O policy information.<sup>360</sup> A non-mandatory disclosure system is more suitable for the U.S. because mandatory disclosure may trigger securities lawsuits against innocent insured corporations.

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<sup>356</sup> *Id.*

<sup>357</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 8(9).

<sup>358</sup> AM. INT'L GROUP (AIG), *supra* note 1, § 4(i).

<sup>359</sup> *See* HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 8(9); HYUNDAI MARINE & FIRE INS., *supra* note 1, at 32 (Insured vs. Insured Exclusion Clause).

<sup>360</sup> *See* Baker & Griffith, *supra* note 37, at 763, 827.

In contrast to the U.S., the Korean Financial Supervisory Service requires a reporting company to disclose D&O insurance information in an annual report.<sup>361</sup> Despite such mandatory disclosure, securities litigation abuse has not yet been reported in Korea.<sup>362</sup> However, securities litigation risks have been increasing since the Korean government reduced the requirements for shareholder derivative actions in 1998 and established a U.S.-style securities class action system in 2004.<sup>363</sup> Moreover, if Korea-U.S. Free Trade Agreements are approved by their respective congresses, a number of U.S. law firms with experience in private securities litigation may begin work in Korea.<sup>364</sup> Thus, changes in recent years may lead to reconsideration of mandatory disclosure of D&O policies in Korea.

## **B. Recommendations for the Reform of the Korean Commercial Act**

The Korean Commercial Act does not provide any standards for D&O insurance.<sup>365</sup> The only mention of such a standard occurs in the Enforcement Decree of the Income Tax Act, which permits a corporation to buy the insurance for its officials by excluding D&O insurance premiums from the tax list.<sup>366</sup> This income tax provision, however, is only weakly linked to D&O insurance regulations.<sup>367</sup> Instead, it would be much more sensible to delineate D&O policy in the corporate section of the Korean Commercial Act.<sup>368</sup> In the U.S., even if insurance laws

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<sup>361</sup> KOREAN FIN. SUPERVISORY SERVICES, AL GI SHI WOON GONG SI SU RUE AN NAE MIT GONG SI MO BUM SA RE JIB [GUIDELINES AND EXAMPLES FOR HOW TO CREATE DISCLOSURE DOCUMENTS] 257-59 (2006), <http://www.fss.or.kr/kr/bbs/view.jsp?menu=dtm080100&idx=410000000041&bbsid=1207404631076>.

<sup>362</sup> See Jung Sik Choi, *Jeong kwon kwan ryun jib dan so song bub eui Gae sun bang an ye Kwan han Go chal* [A Study to Improve The Securities Class Action Act], JUSTIS TONG KWON JE102HO [JUST. VOL.102] 152 (2008).

<sup>363</sup> See Choi, *supra* note 13, at 1508-09.

<sup>364</sup> See Kim, *supra* note 15; Choi, *supra* note 15 at 102-104.

<sup>365</sup> See Black et al., *supra* note 11, at 85.

<sup>366</sup> ENFORCEMENT DECREE OF THE INCOME TAX ACT, art. 38(1)12(e) (S.Korea).

<sup>367</sup> See Kim, *supra* note 243, at 23.

<sup>368</sup> See *id.* at 23; See also Park, *supra* note 152, at 207-08.

generally regulate insurance markets,<sup>369</sup> corporate laws provide more specific regulations for D&O insurance in consideration of corporate realities.<sup>370</sup> For example, the MBCA and Delaware G.C.L. state that a corporation may “purchase and maintain insurance on behalf of” corporate directors or officers.<sup>371</sup> These provisions reflect the corporate world, in which talented managers are reluctant to serve as officials without an insurance policy purchased by a corporation. One solution is to enact provisions that corporations may legally provide insurance for directors and officers, and that the premiums be considered a kind of compensation for the officials under the Korean Commercial Act.<sup>372</sup> The proposed provision would be: “A corporation may purchase and maintain insurance on behalf of its corporate directors or officers. The insurance fee shall be considered a part of the compensation of these directors or officers.”<sup>373</sup>

### **C. Comments for the Reform of Contents in D&O Policy**

#### **1. Clarifying the Scope of Claims**

Korean D&O policy, which does not define claims, may result in more legal disputes regarding D&O insurance coverage than U.S. policies.<sup>374</sup> In order to avoid this problem, Korean D&O policy needs to clarify the scope of claims by defining them. For example, the American AIG policy broadly defines “claim” as including “a written demand for monetary, non-monetary or injunctive relief;” “a civil, criminal, administrative, regulatory or arbitration proceeding for

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<sup>369</sup> See, e.g., DEL. CODE ANN. tit. 18 (1999); CONN. GEN. STAT. ANN. § 38 (West 2007).

<sup>370</sup> See, e.g., DEL. CODE ANN. tit. 8 § 145(g) (2001); CONN. GEN. STAT. ANN. § 33-1123 (West 2005).

<sup>371</sup> MODEL BUS. CORP. ACT § 8.57 (2008); DEL. CODE ANN. tit. 8, § 145(g) (2001).

<sup>372</sup> See Kim, *supra* note 243, at 23.

<sup>373</sup> See, e.g., MODEL BUS. CORP. ACT § 8.57 (2008); DEL. CODE ANN. tit. 8, § 145(g) (2001).

<sup>374</sup> See Hong, *supra* note 184, at 124.

monetary, non-monetary or injunctive relief;” or “a civil, criminal, administrative or regulatory investigation of an insured person.”<sup>375</sup> Some argue that such a broad definition is unwise because it would allow criminal, administrative or regulatory proceedings to be insured, which would violate public policy.<sup>376</sup>

However, there is no concern for violations of public policy under Korean D&O insurance. This is because Korean policy excludes results from the aforementioned proceedings, such as “taxes, civil or criminal fines or penalties, punitive or exemplary damages, the multiplied portion of multiplied damages, or damages increased on an agreement.”<sup>377</sup> Therefore, Korean policy does not cover final judgments in criminal, administrative or regulatory proceedings. Korean D&O policy merely covers the defense costs of such proceedings, which is permissible under public policy.

Such a broad definition of D&O coverage could help avoid disputes regarding whether or not administrative investigations are insured under D&O policy.<sup>378</sup> D&O policies generally cover losses from claims against directors and officers.<sup>379</sup> Therefore, if such investigations fall within claims, policies will cover investigation expenses as well.<sup>380</sup> In *Minute International, Inc. v. Great American Insurance Co.*, the court broadly interpreted claims by holding that SEC investigations should be insured under D&O policy.<sup>381</sup> On the other hand, Minnesota courts have narrowly interpreted claims.<sup>382</sup> Similar to the U.S., in Korea, it could be questionable whether policies cover the Korean Financial Supervisory Services investigations as a kind of claim. Because the purpose of a D&O policy is to support individual directors and officers who

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<sup>375</sup> AM. INT’L GROUP (AIG), *supra* note 1, § 2(b).

<sup>376</sup> *See Hong*, *supra* note 184, at 128.

<sup>377</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, at 16 (definition).

<sup>378</sup> *See Jacobs & Kane*, *supra* note 259, at 150.

<sup>379</sup> Rosenberg, *supra* note 4, at 9.

<sup>380</sup> *See Jacobs & Kane*, *supra* note 259, at 150.

<sup>381</sup> *Id.* at 151 (citing *Minute Int’l, Inc. v. Great American Ins. Co.*, 2004 WL 603482 (N.D.Ill. 2004)).

<sup>382</sup> *Id.* (citing *Foster v. Summit Med. Sys., Inc.*, 610 N.W.2d 350, 354-55 (Minn. Ct. App. 2000)).

cannot solely bear losses, “claims” need to be broadly interpreted to include expenses for the Korean Financial Supervisory Services investigations.<sup>383</sup> Moreover, similar to a lawsuit, investigations take large amounts time and incur high expenses.<sup>384</sup> Therefore, Korean D&O policy would benefit from a broad definition of “claims.” This definition could be worded as follows: “Claim refers to a written demand for monetary, non-monetary or injunctive relief; a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief; or a civil, criminal, administrative or regulatory investigation of an insured person.”<sup>385</sup>

## 2. Guaranteeing the Advancement of Defense Costs

Korean D&O policy gives the insurer the option of advancing defense costs by stating that the insurance company “may” advance defense costs.<sup>386</sup> Similarly, the Korean Commercial Act does not impose upon the insurer the duty to advance defense costs. Instead, it merely states that “the insured may demand from the insurer an advance payment of [defense] expenses.”<sup>387</sup>

If an insurer decides not to advance the expenses, the directors and officers then become responsible for them.<sup>388</sup> However, in the U.S. after *Okada* in 1986, a number of D&O policies started to explicitly state that either defense costs could not be advanced or that the insured had

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<sup>383</sup> *Id.* at 150-51.

<sup>384</sup> *Id.* at 151.

<sup>385</sup> See AM. INT'L GROUP (AIG), *supra* note 1, § 2(b).

<sup>386</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(1); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>387</sup> COMMERCIAL ACT art. 720(1) (S.Korea) (2007).

<sup>388</sup> See Hong, *supra* note 287, at 93.



the right to choose to receive defense costs in advance.<sup>389</sup> Furthermore, many D&O policies began to advance defense costs whether or not an insured corporation paid the expenses.<sup>390</sup>

Covering defense costs is a crucial part of D&O insurance. If the insurer does not cover defense costs, most directors and officers cannot afford litigation expenses before a final decision is reached.<sup>391</sup> This may cause them to lose the lawsuit or settle even if they are not liable.<sup>392</sup> Reimbursing defense costs after losing a lawsuit is futile, and discourages active corporate management.<sup>393</sup> For this reason, the advancement of defense costs ought to be guaranteed for the insured. Therefore, it is recommended that Korean D&O policy contain an explicit provision requiring the advancement of defense costs.<sup>394</sup>

### 3. Revising Settlement Provisions

The English version of Korean D&O policy defines “loss” to include amounts paid in settlement.<sup>395</sup> However, the Korean version merely provides for legal damages and defense costs.<sup>396</sup> It does not explicitly mention judgments or settlements, which means that insuring against them depends entirely upon one’s interpretation.<sup>397</sup> This could lead to disputes regarding the insurer’s responsibility to cover settlement amounts.<sup>398</sup> Therefore, the Korean version needs

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<sup>389</sup> OLSON ET AL., *supra* note 6, § 12:25, at 12-58 to -59.

<sup>390</sup> *Id.* § 12:25, at 12-59.

<sup>391</sup> *See* Aalten, *supra* note 8, at 457; O’KELLY & THOMPSON, *supra* note 34, at 398-99; OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>392</sup> *See* OLSON ET AL., *supra* note 6, § 12:25, at 12-57.

<sup>393</sup> *See id.*; Aalten, *supra* note 8, at 460.

<sup>394</sup> *See* AM. INT’L GROUP (AIG), *supra* note 1, § 8.

<sup>395</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 2.

<sup>396</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 5.

<sup>397</sup> *Id.*

<sup>398</sup> *See* Hong, *supra* note 184, at 143.

to clarify the scope of coverage by defining legal damages in a way which includes judgments and settlements.

In the course of settlements, collusion sometimes occurs between parties or lawyers.<sup>399</sup> Such collusion tends to disadvantage the insurers.<sup>400</sup> Therefore, Korean D&O policy requires that the insured obtain the insurer's written consent prior to settlement.<sup>401</sup> Without such written consent, the insurance company is not obligated to reimburse loss.<sup>402</sup> Both the U.S D&O policy and the English version of Korean D&O policy guarantee the insured's interest by not allowing the insurer to withhold written consent for settlement unless the insurer has reasonable grounds to do so.<sup>403</sup> However, the Korean version does not provide this condition, which allows the insurers to reject settlements whenever they choose.<sup>404</sup> In order to protect the insured, the Korean version ought to include a condition such as the following: "The insurer's written consent to settlement shall not be unreasonably withheld."<sup>405</sup>

#### 4. Providing Specific Allocation Standards

Korean D&O policies do not provide explicit allocation standards.<sup>406</sup> They merely stipulate that "parties cooperate for fair and proper allocation."<sup>407</sup> Such a statement is extremely

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<sup>399</sup> Baker & Griffith, *supra* note 37, at 806-07; OLSON ET AL., *supra* note 6, § 12:26.

<sup>400</sup> See Baker & Griffith, *supra* note 37, at 798; OLSON ET AL., *supra* note 6, § 12:27, at 12-66.

<sup>401</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 19(1)(3); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>402</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 19(1)(3); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>403</sup> HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>404</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, §§ 19-20.

<sup>405</sup> See HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>406</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(4); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

<sup>407</sup> HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 20(4); HYUNDAI MARINE & FIRE INS., *supra* note 1, § 9.

vague, and may lead to legal disputes.<sup>408</sup> In order to prevent such disputes, Korean D&O policy needs to provide more specific standards for allocation.

Two kinds of common law allocation rulings exist in the U.S. D&O insurance system: a relative exposure rule and a larger settlement rule.<sup>409</sup> Between them, the larger settlement rule is more suitable for a civil law system, such as the Korean legal system, because it is a more objective standard than the relative exposure rule.<sup>410</sup> Under the larger settlement rule, “allocation may only reflect the extent to which the settlement was larger because of claims against uninsured persons or the actions of persons against whom no claims were made.”<sup>411</sup> However, the relative exposure rule depends entirely upon judicial discretion.<sup>412</sup> Therefore, it is suggested that Korean D&O policy include a provision requiring allocation to be based on larger settlements.<sup>413</sup> Otherwise, in an effort to avoid allocation disputes, both parties in an insurance contract may make an agreement including entity coverage or a pre-determined allocation percentage.<sup>414</sup> As shown in Joseph P. Monteleone’s study, one model of the pre-determined allocation could be stated as follows:

Allocation of Securities Claims. The Company, the Directors and/or Officers and the Insurer agree to allocate to covered Loss the following portions of any Allocable Amount incurred with respect to a Securities Claim:

- A. \_\_\_% of all Securities Claim Expenses; and
- B. \_\_\_% of all Securities Loss other than Securities Claim Expenses.

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<sup>408</sup> See Hong, *supra* note 287, at 102; Monteleone & Conca, *supra* note 345, at 608.

<sup>409</sup> Jacobs & Kane, *supra* note 259, at 152-53.

<sup>410</sup> See *Caterpillar, Inc. v. Great American Ins. Co.*, 62 F.3d 955, 959 (7th Cir. 1995); Jacobs & Kane, *supra* note 259, at 152-53 (listing factors to be considered under the relative exposure rule: “the motivations and intentions of the settlement negotiators; the burden of the litigation; the likelihood of adverse judgment in the underlying litigation; settlement and defense funding; the “deep pocket” factor and the potential effect on the liability of each beneficiary”).

<sup>411</sup> *Caterpillar, Inc.*, 62 F.3d at 964.

<sup>412</sup> See *id.* at 955; See Jacobs & Kane, *supra* note 259, at 152-53.

<sup>413</sup> See, e.g., *Harbor Ins. Co. v. Cont’l Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990); *Caterpillar, Inc.*, 62 F.3d 955.

<sup>414</sup> See MATHIAS ET AL., *supra* note 37, § 6.04[4], at 6-49.

This agreed allocation shall be final and binding on the Directors and/or Officers, the Company and the Insurer.<sup>415</sup>

## 5. Limiting the Scope of the Insured v. Insured Exclusion

The main purpose of the insured v. insured exclusion is to prevent collusive or “friendly” litigation designed to transfer money from the insurer to the corporation.<sup>416</sup> If there is no collusion involved in the claim, this exclusion should not apply.<sup>417</sup> The insured is to be covered under the policy when “such [a] security holder’s or member’s Claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Executive of an Organization or any Organization.”<sup>418</sup> However, Korean D&O policy does not identify exceptions for the exclusion.<sup>419</sup> Thus, in cases where collusion cannot arise, the insured is not covered under D&O policy.<sup>420</sup> Such a problem can easily be remedied by modeling the exclusion after the U.S. D&O policy terms.<sup>421</sup> Therefore, the insured v. insured exclusion ought to include an exception as follows: “The insured is to be covered when a claim is made totally independent of any organization or its executives.”<sup>422</sup>

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<sup>415</sup> Monteleone, *supra* note 346, at 43.

<sup>416</sup> Township of Ctr., Butler Co., Pa. v. First Mercury Syndicate, Inc., 117 F.3d 115, 119 (3d Cir. 1997); KNEPPER & BAILEY, *supra* note 47, § 25.08, at 25-19.

<sup>417</sup> See, e.g., AM. INT’L GROUP (AIG), *supra* note 1, § 4(i).

<sup>418</sup> *Id.*

<sup>419</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 8(9); HYUNDAI MARINE & FIRE INS., *supra* note 1, at 32 (Insured vs. Insured Exclusion Clause).

<sup>420</sup> See HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 8(9); HYUNDAI MARINE & FIRE INS., *supra* note 1, at 32 (Insured vs. Insured Exclusion Clause).

<sup>421</sup> See, e.g., AM. INT’L GROUP (AIG), *supra* note 1, § 4(i).

<sup>422</sup> See *id.*

## D. Specification of Guidelines for D&O Insurance Coverage in Litigation

Defense costs are another area of potential controversy in Korea.<sup>423</sup> The Korean Commercial Act states that the insured may demand defense costs in advance. It also states that if the insurer leads the defense, the insurer should pay the entire loss regardless of whether or not the defense costs extend beyond the coverage.<sup>424</sup> Specific processes, such as allocation, rely on policy provisions.<sup>425</sup> However, these policy provisions regarding allocation are too vague to solve specific legal issues which may arise.<sup>426</sup> In order to clarify these provisions, as mentioned previously, some reform of the Korean Commercial Act and D&O policy is needed. However, revision of current statutes and policies will take a great deal of time. Until such a revision of the Korean Commercial Act and D&O policy can be made, the guidelines published by the Korean Financial Supervisory Service in 2005 may be useful.<sup>427</sup> However, these guidelines are not sufficient to meet the demands of future D&O insurance disputes. Therefore, regulatory institutions, such as the Financial Supervisory Service, ought to improve the guidelines. This can be accomplished by utilizing the U.S. policies and common law which provide an example of how to specify legal processes such as purchasing, coverage, defense costs, settlements, allocations and exclusions.

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<sup>423</sup> See Kim, *supra* note 243, at 32.

<sup>424</sup> COMMERCIAL ACT art. 720(3) (S.Korea).

<sup>425</sup> Kim, *supra* note 243, at 32.

<sup>426</sup> *Id.*

<sup>427</sup> See KOREAN FIN. SUPERVISORY SERVICES, SANG JANG BUB IN EUI IM WON BAE SANG CHAEK IM BO HUM GA IB YE KWAN HAN GA EE DE LA IN JE JUNG [GUIDELINE FOR D&O INSURING OF LISTED COMPANY] (2005), [http://www.fss.or.kr/kr/nws/nbd/bodobbs\\_v.jsp?menu=nws020100&seqno=10342&gubun=01](http://www.fss.or.kr/kr/nws/nbd/bodobbs_v.jsp?menu=nws020100&seqno=10342&gubun=01).

## VI. Conclusion

This paper has discussed D&O liability insurance system in the U.S. and South Korea with particular emphasis placed on protection of corporate directors and officers from the burdens of securities litigation. D&O liability insurance is a special insurance product which covers loss arising from claims made against directors and officers.<sup>428</sup> Corporate directors and officers are subject to many responsibilities.<sup>429</sup> If they breach these duties, they may be exposed to huge financial risks arising from civil lawsuits, criminal proceedings or administrative investigations. Among other things, such litigation and investigations can result in a tremendous monetary loss to corporate officials. Because of these risks, many talented people may avoid serving as corporate directors or officers. Thus, corporations often seek D&O protections to assure that they find gifted individuals to manage their businesses. There are two types of D&O protection: indemnification and insurance.<sup>430</sup> Indemnification has many limitations. Indemnification cannot support directors if they violate federal securities law and is based upon on the corporation's ability to pay. In contrast, insurance does not have such limitations. The SEC considers D&O insurance to be lawful and permissible, and has not prevented corporations from insuring against violations. Therefore, D&O insurance is the main source of protection for directors and officers.

In the U.S., this insurance was introduced in the 1930's.<sup>431</sup> In Korea, major corporations started to purchase the policy after the Asian economic crisis in 1997.<sup>432</sup> In 2004, 34.4% of

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<sup>428</sup> See AM. INT'L GROUP (AIG), *supra* note 1, § 1; HYUN DAI HAE SANG [HYUNDAI MARINE & FIRE INS.], *supra* note 1, § 2; HYUNDAI MARINE & FIRE INS., *supra* note 1, § 1.

<sup>429</sup> See *supra* Chapter II.Part A.

<sup>430</sup> See *supra* Chapter II.Part B.

<sup>431</sup> Monteleone, *supra* note 5.

<sup>432</sup> Eun, *supra* note 9, at 24.

companies listed on the Korea Exchange maintained the policy.<sup>433</sup> However, lack of experience with D&O insurance may cause problems in operating the system.<sup>434</sup>

Most importantly, there is a “moral hazard” concern that D&O insurance could weaken the deterrent function of securities law.<sup>435</sup> However, D&O premiums may function as an indicator of corporate health because D&O insurers monitor corporate financial condition and corporate governance when deciding the coverage.<sup>436</sup> Therefore, D&O insurance does not interfere with the deterring role of corporate and securities law, but rather actually supports that function.

Another concern about D&O insurance is that the Korea Commercial Act does not provide any regulatory standards.<sup>437</sup> Thus, controversy exists concerning whether or not a corporation has the right to purchase such insurance on behalf of directors and officers. In order to avoid disputes regarding the purchaser, this paper proposed that the Korea Commercial Act provide explicit provisions to allow corporations to purchase D&O policy for directors and officers.

A third concern is that Korean D&O policy has a Korean version and an English version. The coexistence of the two different versions causes confusion in analysis and application of Korean D&O policy. Therefore, some revision of its provisions is required. Among other things, similar to the U.S. D&O policy and English version of the Korean policy, the Korean version needs to clarify the scope of coverage by defining legal damages to include judgments and

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<sup>433</sup> KOREA LISTED COMPANIES ASS’N, JU KWON SANG JANG BUB IN IM WON BAE SANG CHAEK IM BO HUM GA IB HYUN HWANG [DIRECTORS AND OFFICERS LIABILITY INSURANCE SURVEY FOR KOREAN LISTED COMPANIES] BO DO JA RYO [NEWS RELEASE] 1 (2005), <http://www.klca.or.kr/>.

<sup>434</sup> See *supra* Chapter I.Part A.

<sup>435</sup> See Baker & Griffith, *supra* note 64, at 1817-19.

<sup>436</sup> See *supra* Chapter II.Part C.

<sup>437</sup> See *supra* Chapter V.Part B.

settlements.<sup>438</sup> In addition, in order to protect the insured, the Korean version ought to guarantee the insured's coverage interest by not allowing the insurer to withhold written consent to settlement unless the insurer has reasonable grounds to do so.

Another potential issue arises because practice with the insurance and relevant jurisprudence is limited in Korea. However, in the U.S., a number of cases about D&O insurance have been accumulated and discussed. Therefore, it is proposed that American solutions to the issues arising in D&O insurance be applied in the Korean system. Among other things, in order to avoid legal disputes in this area, Korean D&O policy needs to clarify the scope of claims, the advancement of defense costs and the standards of allocation.<sup>439</sup> Moreover, in light of protecting the insured's interest, the scope of the insured v. insured exclusion needs to be limited. However, much time is necessary for such reform of current statutes and policies,<sup>440</sup> and thus Korean regulatory institutions first need to improve their guidelines.

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<sup>438</sup> *See supra* Chapter V.Part C.3.

<sup>439</sup> *See supra* Chapter V.Part C.

<sup>440</sup> *See supra* Chapter V.Part D.