

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

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Executive Liability

Unique loss exposures faced by corporate executives

Recent years have witnessed a dramatic increase in the number of lawsuits filed against those who manage corporations or serve on their boards of directors. Unlike a typical general liability claim, however (claims alleging bodily injury or property damage arising out of your negligence), these lawsuits assert personal liability on the part of the executives, thus placing their personal assets at risk.

These exposures are compounded by the fact that they are relatively recent in origin. Prior to 1970, claims against directors and officers were quite rare. Prior to the passage of the Employee Retirement Income Security Act (ERISA) in 1974, fiduciary liability and employee benefit liability exposures were relatively modest. Before the Clarence Thomas confirmation hearings in 1991, sexual harassment claims, although not unusual, hardly posed the threat to corporate America that they do today.

Furthermore, recent laws pertaining to executive liability exposures along with rapidly evolving insurance coverage forms combine to make this a complex issue. The Private Securities Litigation Reform Act aimed to shield corporate directors and officers from liability. On the other hand, the Family and Medical Leave Act increased the risks faced by executives. Court rulings interpreting these statutes are being issued almost daily.

Lastly, as the nature of these risks have changed, so have the insurance policies written to cover them. Employment practices liability, for example, when first introduced in the early 1990s,

was much narrower in scope than the policy forms that are currently available.

Given the swiftly changing environment, corporate executives require the protection afforded by complex, highly specialized insurance policies. These include:

- Directors and Officers Liability
- Employment Practices Liability
- Fiduciary/Employee Benefits Liability
- Kidnap/Ransom/Extortion Liability

Directors and Officers Liability

Directors and Officers Liability Insurance (D&O) covers directors and officers for their liability arising out of their performance on behalf of the corporation. In other words, if the performance of the directors and officers falls below the standard of care established in the industry, they can be held liable. Directors and officers liability insurance provides coverage for this exposure.

D&O policies will protect the directors and officers from their liability arising out of misstatements or misleading statements, as well as acts, er-

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rors or breaches of duty that arise from business decisions. Essentially, it's an errors and omissions policy for the directors and officers.

Although the majority of lawsuits against directors and officers come from shareholders, lawsuits can also come from third parties.

Unlike most policies, D&O policies do not cover the organization (the entity). They only cover the directors and officers themselves. They do cover claims for which the organization is required to indemnify the directors and officers. Thus, if a suit names only the organization, a D&O policy would provide no coverage. (Recently, some insurance companies have been willing to provide direct coverage for the corporate entity by means of "entity coverage" endorsements.)

Because of this, a D&O policy contains two distinct coverages, one for the individual directors and officers, and a second for the organization's loss in reimbursing the directors and officers for claims in which the corporation is legally obligated to do so.

Although the two separate coverage parts share an indivisible limit of coverage, there are two separate deductibles. The deductible applying to the individual directors and officers is usually significantly less than the deductible applying to the corporate reimbursement section.

Under a typical D&O policy, the insurer has no duty to defend the insured, although insurers do have the right to participate in the defense of a claim. D&O policies are also written with a number of distinctive exclusions, such as prior and pending litigation, "green mail" (when an organization buys its stock at above market price), short-swing profits, return of remuneration, and the securityholder exclusion (which precludes coverage when a director or officer uses a third party as a front to sue the company).

Prior to purchasing directors and officers liability insurance, it is recommended that you review the policy form carefully and discuss any questions that you might have with your broker. It is also a good idea to discuss the coverage with your corporate counsel.

Employment Practices Liability

Employment Practices Liability Insurance (EPL) is intended to cover four major perils: discrimination, sexual harassment, wrongful termination, and workplace torts. Allegations of this type are typically excluded under both your general liability and workers compensation policies (limited coverage may be provided under a directors and officers liability policy).

- **Discrimination** claims are often based on failure to hire, failure to promote, unjust demotion, and discriminatory slurs or comments.
- **Wrongful termination** is the act of terminating an employee in a manner that is against the law.
- **Sexual harassment** encompasses unwelcome sexual advances, requests for sexual favors, and verbal, visual and physical conduct of a sexual nature.
- **Workplace torts** include allegations that do not fall within the categories of wrongful termination, sexual harassment and discrimination, and may include (but are not limited to) failure to grant tenure, invasion of privacy, negligent evaluation, and false imprisonment.

Employment practices liability policies are written on a claims-made and reported basis, and only cover claims that are made and reported during the policy period. In addition, they exclude any claims or claims circumstances of which you were aware or should have been aware at the time you took out coverage.

The limit of liability is an aggregate limit for the policy term and will be reduced by any defense costs. Deductibles apply on a per claim basis and also include defense costs.

Key exclusions found in an EPL policy include ADA compliance costs, strikes and lockouts, downsizing claims, retaliatory actions, claims by relatives, claims for non-pecuniary relief, claims for future pay, and claims from breach of an express employment contract. These are exclusions commonly included with most policies. Your specific policy should be reviewed for additional or ac-

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tual exclusions.

Although most EPL policies provide relatively broad coverage, they are all different, and they all contain exclusions (some more than others). Before purchasing a policy, you should review the policy form carefully. Any questions you have should be called to your broker's attention for an explanation. You should also consider having your legal counsel review the policy form.

Fiduciary and Employee Benefits Liability

Fiduciary liability insurance protects persons and organizations against liability from breaches of fiduciary duty that they incur in creating and managing employee benefits programs.

Claims against fiduciaries can involve plan mergers or terminations, claims caused by negligence, claims involving plan disclosures, claims caused by imprudent investments, claims alleging failure to pursue delinquent contributions, and claims involving a number of miscellaneous allegations.

Fiduciary liability insurance, ERISA-mandated bonding requirements, and employee benefits liability coverage often are confused.

- Fiduciary liability insurance – Fiduciary coverage applies to breaches of duty specified by ERISA (e.g., failure to prudently invest assets).
- ERISA mandated bond – ERISA mandates that fiduciaries and persons who handle plan funds or other plan assets to be bonded for a minimum of 10% of the aggregate amount handled subject to a maximum bond of \$500,000. The bond basically covers theft of plan assets by a fiduciary.
- Employee benefits liability insurance –

Employee benefits liability coverage applies to administrative (i.e., non-judgmental) errors involving pension and benefit plans (e.g., failing to name an intended beneficiary on a company-provided life insurance policy).

Most, but not all, fiduciary liability forms also cover employee benefits liability claims, although employee benefits liability can be purchased as an endorsement to most commercial general liability policies at a fairly modest cost.

Note that of the three coverages, only the ERISA bond is required by law.

Kidnap, Ransom and Extortion Liability

Since the 1970s, a rash of well-publicized incidents have involved the kidnapping of corporate executives. Used as pawns to extort huge sums from their employers, these kidnapping victims are often terrorized, sometimes injured, and occasionally killed.

The coverage is actually quite broad, and includes costs associated with kidnap and ransom/extortion payments, wrongful detention costs, in-transit delivery expenses, miscellaneous expenses, judgments, settlements, and defense costs, and death and dismemberment coverage.

Conclusion

Needless to say, it is not as simple to be an officer or a director today as it was 20 years ago. Liability has increased dramatically, and insurance coverages to protect executives from these liabilities have surfaced to provide protection.

If you have questions about any of these exposures, or are interested in indications of cost, please don't hesitate to contact us. ✦

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Making Sense of Insurance Terms

Understanding certain terminology within your business insurance policy is crucial to knowing exactly what is – and what is not – covered. To get business owners familiar with insurance terms, the California Department of Insurance offers the following definitions.

- Quote – An estimate of the cost of insurance based on information supplied to the insurance company by the applicant
- Policy Limit – The maximum amount a policy will pay, either overall or under a particular coverage
- Underwriting – The process of selecting applicants for insurance and classifying them according to their degrees of insurability so the appropriate rates may be charged (the process includes rejection of unacceptable risks)
- Premium – The amount of money an insurer charges for insurance coverage
- Peril – The cause of a possible loss (i.e., fire, theft or hail)
- Endorsement – Occasionally called a “rider,” an endorsement is an amendment to the policy used to add or delete coverage
- Exclusion – Certain causes and conditions listed in the policy which are *not* covered
- Deductible – The amount of the loss which the insured is responsible for paying before benefits from the insurance company are payable (you may choose a higher deductible to lower your premium)
- Actual Cash Value – An amount equivalent to the replacement cost of stolen or damaged property at the time of the loss, less depreciation
- Replacement Cost – The full cost to repair or replace an insured item (some insurers only pay the actual cash or market value of the item at the time of the loss, not what it would cost to fix or replace it) ✦

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