

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

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D&O Insurance

Do directors and officers of privately owned companies need coverage?

By Peter Taffae

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Brown & Riding*

Increasing litigation is causing more companies than ever to consider directors and officers (D&O) insurance. While directors and officers liability insurance was originally designed to protect shareholders of publicly held corporations from claims, today's coverage has expanded to meet the needs of companies of all sizes and ownership types – none of which are immune to claims against their directors and officers.

Corporate directors and officers have a responsibility not only to shareholders, but to all stakeholders, to ensure that the corporation is managed in their best interests. Because corporations are subject to extensive governmental regulation in their formation, operation and dissolution, directors and officers are exposed to personal liability. Directors and officers may be held personally liable for all losses to the corporation caused by their failure to ensure that the corporation is in compliance with applicable laws.

Size Doesn't Matter

Increased litigation and skyrocketing defense costs are driving the average D&O payment to nearly \$3.3 million, and organizations are finding that neither size nor ownership structure provides immunity from costly lawsuits. Although privately held companies have generally considered D&O coverage as being irrelevant, they are at risk. They may have even

more risk than publicly held corporations because they do not have access to the same amount of resources to assure their compliance with laws and to manage their relationships with employees and their investors.

Most lawsuits don't come from shareholders, but from creditors, contractors, competitors, government bodies, employees, and anyone else who might be affected by the decisions of directors and officers. Contrary to popular belief, these groups account for more than 50 percent of lawsuits covered by D&O liability insurance. Even if corporations have bylaws indemnifying officers and directors for suits brought against them, the corporation's balance sheet will be adversely affected by legal fees and any settlement. The possibility of the corporation becoming insolvent or going bankrupt, in which case directors and officers can become personally liable, also exists.

Employment related claims are one of the fastest growing areas of litigation, and a rising source of claims filed under D&O liability policies. Employee-brought lawsuits can range from allegations of

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sexual harassment to age discrimination to plant closings and reduction of work force.

When someone holds a position of leadership, they are exposed to potential legal liability, regardless of the size or ownership structure of the organization. Unfortunately, privately held firms often underestimate their D&O liabilities. Lacking legal counsel or full-time risk managers, many privately held firms erroneously think that their general liability policy adequately covers all claims, including those that are employee-related.

Concern From Companies

The need for directors and officers liability insurance, regardless of company size, is clearly indicated by a study conducted by Louis Harris and Associates. The study surveyed more than 500 outside directors and included directors of smaller public companies as well as privately held firms.

The results of the study regarding smaller corporations and privately held firms are especially interesting. Four out of ten private firm directors reporting feeling that their risk of being sued was equal to or

greater than that faced by public company directors. In fact, directors of small public and private companies have the highest level of concern on issues such as D&O adequacy and lawsuits.

Directors of smaller companies are becoming increasingly aware of the non-shareholder types of liabilities that can arise, such as employment and creditor related liabilities – and tend to be more involved in day-to-day decision making. This may explain why they feel more exposed to the liabilities that some of their decisions could create.

It is important that insurance brokers and agents help small and mid-sized businesses understand that D&O issues are not just relevant to large, publicly held companies. Large or small, public or private – no one is immune. An uninsured D&O claim can financially devastate both corporations and individuals. With litigation on the rise and claims frequency increasing, average costs for D&O claims are exceeding \$3.3 million. Justification and need for D&O coverage exists for companies of all sizes, public and private. ✦

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Online Criminals Threaten Businesses

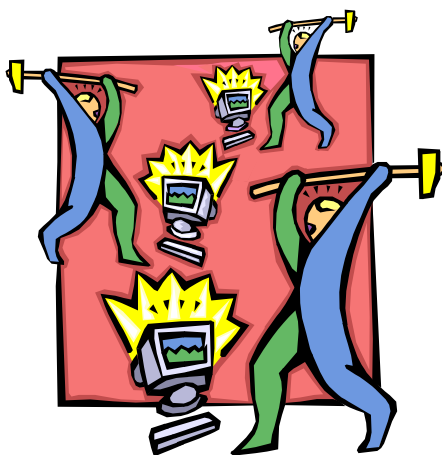
The Internet has drastically changed the way many people do business. We can now shop for anything from groceries to clothing to even cars online without leaving the comfort of our homes. However, this new technological age has also spawned a new breed of criminals. In 1998, more than 50% of all businesses reported some type of losses which totaled more than \$200 billion.

According to Candysse Miller, regional director of the Western Insurance Information Service, “While a mousepad won’t kill you, it can kill your business.” This technological age graffiti has pro-

duced a need for insurance coverage that can protect businesses against high-tech thieves.

Most business insurance policies do not cover losses resulting from “Cyber Crimes.” However, there are anti-hacker policies available that cover losses like theft of securities or tangible property via computer, software damage and business interruption expenses.

Prior to obtaining insurance, companies generally must undergo a computer security assessment to determine their amount of risk. A business that determines it requires



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\$12 million worth of coverage would pay about \$25,000 a year. The WIIS suggests companies use the following tips to protect themselves from cyber criminals:

- Assess information assets and vulnerability
- Identify potential enemies
- Establish strict company policies as to who has access to what types of information, and use the employee handbook to publish this information.
- Periodically change employee passwords.
- Install an intrusion detection system on your computer system.
- In the event an attack occurs, call in a computer forensics investigator who may be able to find “electronic fingerprints” that may help determine the identity and/or location of the perpetrator.

Remember that the damage caused by one hacker could result in losses in the million-dollar range for your business. While anti-hacker coverage can help offset losses in the event of a breach of security, it also proves valuable in that it forces companies to become more aware and involved in the protection of their computer systems. ✦

Facts About Insurance Fraud

If you own a business, you are a target for fraud. Those especially vulnerable include retail stores, restaurants, casinos, tourist attractions, and government buildings.

Insurance fraud is the second largest economic crime in the United States, second only to tax evasion. It represents a multi-billion dollar cost each year to every American business in the form of higher insurance premiums, taxes, and costs of other goods and services.

The Coalition Against Insurance Fraud says that insurance fraud is not a victimless crime. Because businesses suffer an enormous financial toll, these costs must be passed along to the consumer, thus affecting every sector of American life.

However, the insurance industry is fighting back. Through combined efforts of insurance companies, agents, law enforcement, insurance fraud groups, and state and federal legislators, the insurance industry is recouping \$5 billion dollars in fraudulent claim payments every year.

What is insurance fraud?

Fraud is a deception deliberately practiced to secure unfair or unlawful gain, such as:

- Deliberately staging or inventing an accident, injury, theft, arson or other loss that would be covered by insurance.
- Padding or exaggerating an insurance claim.
- Charging for goods or services that are unneeded or undelivered.
- Failing to disclose truthful and accurate information on any insurance application (such as medical history, driving record, and past claims experience, to name a few).

What you can do

If you suspect insurance fraud:

- Report it to local law enforcement
- Contact your insurance agent
- Call the California Department of Insurance
- Report it to the National Insurance Crime Bureau at www.nicb.org ✦



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Direct Dial Phone Numbers

Due to a change in telephone providers at our new location, it was necessary for Cavignac & Associates to change its direct dial phone numbers from those listed in our moving announcement. The new phone numbers are as follows:

<hr/> <i>We now have "Direct Dial" access to our staff and their personal Voice Mail lines during office hours, and Voice Mail access 24 hours a day, 7 days a week. Now you can reach any member of our staff or leave a Voice Mail message without having to go through an operator. If you forget your party's number, call our main office line (still 619-234-6848) and press "*2" for directory listings by first name.</i> <hr/>	Principals	Jeffrey Cavignac	619-744-0567
		Robert Supple	619-744-0555
		Jim Schabarum	619-744-0565
		Scott Bedingfield	619-744-0560
	Account Executives	Dorothy Amundson	619-744-0566
		Michael Strahan	619-744-0573
		Jeffrey Steen	619-744-0574
	Account Managers	Penny Edgell	619-744-0568
		Jolinda Kramer	619-744-0578
		Susan McFarland	619-744-0572
		Bettye McLaurin	619-744-0556
		Celia Mondfrans	619-744-0570
		Lisa Wachholz	619-744-0571
	Assistant Account Managers	Sandy Hofmann	619-744-0576
		Merchanti Mongold	619-744-0558
		Estela Rodea	619-744-0562
	Office Manager	Sue Marberry	619-744-0564
	Administrative Assistant	Michael Lynn Edwards	619-744-0550
	Communications Coordinator	Ginger Cornwell	619-744-0577

Note:

On 11/19/99 I called Sky Barnhart, Editor (619-455-7717) of the Insurance Journal to obtain permission to use Peter Taffae's article in our mailer. We need to send a copy of the completed mailer to:

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Special thanks to Peter and his assistant Stephanie, who gave me a call with the name and phone number of the individual to speak to at the JOURNAL. -GC