

SPECIAL ISSUE

# WHAT PRIVATE FIRMS & NONPROFITS NEED TO KNOW ABOUT D&O



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Aon Risk Solutions

# Intuition or facts?

Claw backs, bankruptcies, EPLI and the list goes on. In 2011, there was no shortage of issues, lawsuits and decisions impacting the role of the C-suite, board of directors and risk manager.

Executive liability is a complex, evolving area. Thankfully, Aon Risk Solutions compiles an annual Year in Review to catch you up on legal news and developments in executive liability you may have missed.

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# Executive liability rising for private, nonprofit firms

*However, businesses often lack coverage for all potential risks*

By **MATT DUNNING**

Though privately held companies and nonprofit organizations are becoming more sophisticated in managing their executive risks, some misconceptions still persist with regard to the true nature of their liability exposures and the insurance products designed to guard against them.

More than one out of every four private or nonprofit firms doesn't have directors and officers insurance for their executive employees and board members, according to a 2012 *Business Insurance* survey (see story, page 4).

Asked why they forgo the coverage, 48% of private companies and 80% of nonprofits said they do not believe their company needs it. At least 10% of the uninsured private and nonprofit companies said they believe their D&O risks are covered under another insurance policy, while 3% said they didn't know enough about their risks or the insurance products.

The reality is that executive liability claims can originate from a variety of sources, and they can harm a private or nonprofit organization of any size in practically any industry. The majority of those claims are filed in defense of an employee practices lawsuit, but other sources of litigation can include customers and clients, competitors, minority shareholders, lenders and donors, government agencies, foreign entities, and fellow executives or board members.

In this special issue of *Business Insurance*, liability and insurance experts and observers address key executive risk exposures, coverage issues, market trends and risk management solutions, all with an eye toward improving understanding of executive risk among insurance buyers at privately held and nonprofit companies.

Facing steady increases in state and federal investigations and enforcement actions, reforms in health care, as well as banking and

See **RELUCTANCE** next page



## SPECIAL ISSUE EXECUTIVE RISKS

While discussions of directors and officers liability issues tend to focus on shareholder class actions against large, public companies, privately held and nonprofit organizations face a host of other risks that expose their directors and officers to liability.

In this special issue, *Business Insurance* takes a close look at those evolving risks, as well as examining the insurance and loss control strategies that can help private and nonprofit organizations respond to them.

In addition, the issue features the findings of a *Business Insurance* survey that sheds light on the D&O liability risk awareness and insurance buying habits of private and nonprofit organizations—including detailed information on claims experience and coverage limits—as well as a special pull-out Data Poster featuring our D&O “sector snapshot.”

Such research is a central feature of *Business Insurance*'s special issues, supplementing our extensive coverage with data that provides insights into peers' experience, analysis of relevant market trends and industry vendors, and other data designed to help readers confront critical business challenges.

## INSIDE THIS ISSUE

**DATA** D&O purchasing patterns and perceptions of risk often don't match. **PAGE 4**

**PERSPECTIVES** Fiduciary risks evolving at private and nonprofit companies. **PAGE 9**

**REGULATION** Regulatory risks can vary significantly by industry. **PAGE 10**

**DEFAMATION** Disparaging remarks about products, services more likely to spark litigation. **PAGE 12**

**BANKRUPTCY** Even though bankruptcy filings have eased, D&O exposures remain. **PAGE 14**

**FAMILY OWNED** Family member vs. family member litigation often overlooked as threat. **PAGE 16**

**WEBINARS** Three webinars address mid-market D&O and disaster risks. **PAGE 17**

**HEALTH CARE** The health care reform law increases risks for health care organizations. **PAGE 18**

**NONPROFIT** Reputational, employment practices among major risks for nonprofits. **PAGE 19**

**OVERSEAS** U.S. companies face mounting D&O risks from international operations. **PAGE 20**

**RATES** Executive liability market shows some signs of firming. **PAGE 22**

**OPTIMAL** To achieve optimal coverage, some best practices cut across industries. **PAGE 24**

**ADMITTED** How do organizations working abroad ensure that their coverage will respond? **PAGE 25**

**PERSPECTIVES** Contract language determines whether coverage responds to a claim. **PAGE 26**

**PERSPECTIVES** How to protect against employment practices liability claims. **PAGE 28**

## INDEX

Ad Index **PAGE 27** / BI Classified **PAGE 24**  
Business Resources **PAGE 24** / End Page **PAGE 30** /  
News in Brief **PAGE 29** / Opinions **PAGE 8** /

# Covered or bare?

## Survey measures D&O purchasing

Many buyers skip broadest coverage, BI research shows

By JOANNE WOJCIK

When it comes to directors and officers liability risks, the perception and the reality can differ for private and nonprofit organizations, new research from *Business Insurance* shows.

Privately held companies and nonprofit organizations surveyed by *Business Insurance* cited regulatory litigation as their top D&O concern, but the data shows that employment practices litigation is actually their No. 1 exposure based on claims experience.

The survey also found that a large majority of both private companies and nonprofit organizations purchase D&O coverage, but that only about half are buying complete coverage for directors, officers and the entity itself.

Seventy-one percent of privately held companies said they purchase D&O insurance, while 74%

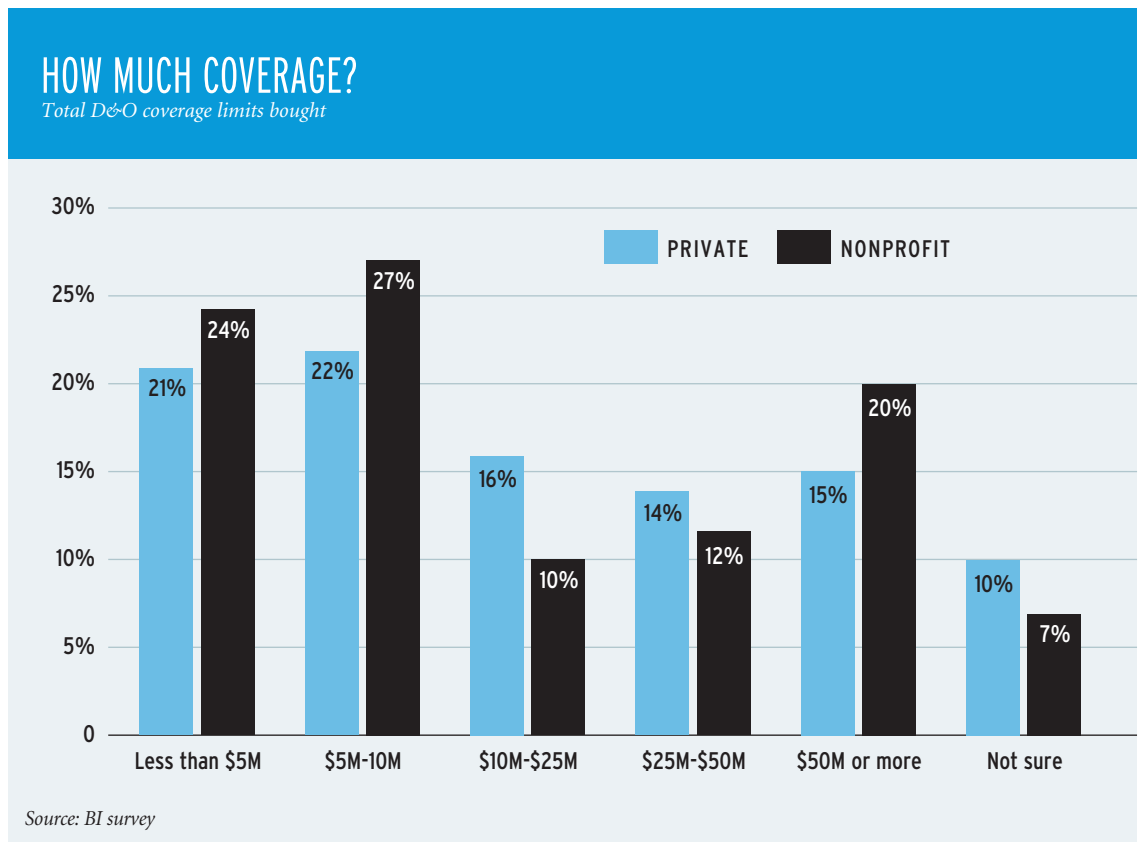
of nonprofit companies do.

When asked to identify their top three D&O liability concerns, 52% of privately held companies said litigation filed by customers or competitors was their top concern followed by regulatory litigation exposures, cited by 48%, and employment practices liability, named by 38%.

Meanwhile, 60% of nonprofit organizations participating in the BI survey cited regulatory litigation exposures as their greatest concern. EPL was No. 2, cited by 50%, and lawsuits filed by customers and competitors was No. 3, at 42%.

However, of the 20% of privately held companies and 11% of nonprofit organizations that filed a claim against their D&O policies over the past three years, the top reason for the claim was EPL, cited by 47% of those privately held firms and 57% of those nonprofit entities.

The survey was conducted by Signet Research Inc. for *Business Insurance* to gauge the D&O exposures and insurance purchasing habits of privately held companies



and nonprofit organizations (see story, page 6).

The second most frequent type of D&O claim activity identified by privately held companies, cited by 33%, was for lawsuits filed by minority shareholders, lenders, donors, etc. The third most frequent type of claim was for suits filed by customers or competitors, named by 22% of private firms.

EPL also was the most frequent claim type for nonprofit companies, identified by 57% of survey respondents, followed by lawsuits filed by customers or competitors or regulatory litigation exposures, each cited by 29% of respondents.

Other leading liability concerns identified by survey respondents were financial and accounting exposures, cited by 35% of privately held and 30% of nonprofit firms; fiduciary liability for health and/or pension plan administration, selected by 14% of privately held firms and 29% of nonprofits; and employee theft and dishonesty, identified by 14% of privately held companies and 15% of nonprofits.

Additionally, 27% of privately held firms said product liability exposures were a major concern, while 21% of nonprofits identified audit control gaps.

Among the most common business activities in which the survey respondents from privately held firms were engaged that could potentially lead to D&O claims were: mergers and acquisitions, domestic retail or manufacturing, government contracting and possession of intellectual property and/or patent holdings, international import or export of components and/or products, overseas retail or manufacturing, possession of overseas operations and recruiting new directors (see chart, page 6).

See **RISKS** page 6

## Reluctance: Why companies forgo D&O insurance

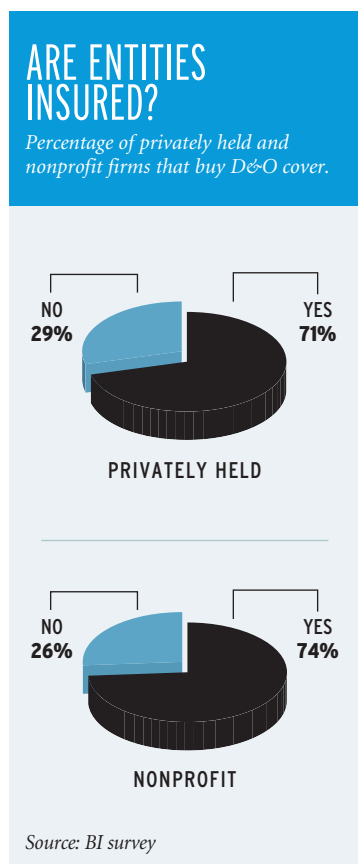
CONTINUED FROM PREVIOUS PAGE

consumer protection that are likely to generate new liabilities, a majority of surveyed risk managers and other insurance buyers said regulatory litigation was their most troubling liability exposure.

In particular, risk managers and insurance professionals in the health care industry are only beginning to sort out the potential impact of the formation of accountable care organizations in response to passage of federal health care reform.

Even before the passage of the Patient Protection and Affordable Care Act of 2010, consolidation was triggering antitrust litigation in the health care arena. Today, doctors and hospitals that are not included in ACO networks could sue the ACO's directors and officers, asserting they are being prevented from obtaining patients.

While the possibility of antitrust litigation is perhaps of greatest concern to directors and officers of hospitals, health care systems and other medical care organizations that integrate to form ACOs, they also may encounter allegations that they violated anti-referral and anti-



kickback laws, legal experts note. Additionally, potential conflicts of interest could arise if directors and

officers serve on hospital and ACO boards simultaneously.

Customers, clients and competitors also pose a significant risk to private and nonprofit companies. Industry observers have noted a recent increase in lawsuits among competing firms that accuse executives and board members of slander, defamation of character and comments disparaging their products or services. Litigation over the theft or infringement of intellectual property, trademarks and patents is also frequent. Depending on their industry and business model, some insurance buyers may find it difficult to secure coverage for those exposures.

Because family ownership is common among private and nonprofit firms, disagreements over management or investment decisions can get personal. When those disagreements spill over into a courtroom, even well-written D&O policy forms might not protect the company from incurring significant legal costs, since most underwriters won't cover litigation between insured parties.

Regardless of the service they provide, directors and officers of nonprofit firms can be sued by

donors, beneficiaries or the government for breaches of their fiduciary responsibilities, mismanaging collected funds, acting beyond their chartered authority or violation of state or federal laws, nonprofit risk experts said. Nonprofit executives also could find themselves facing client accusations of harassment, discrimination, poor products or poor service; accusations by competitors alleging unfair trade practices; or accusations by vendors and suppliers alleging breach of contract.

In addition to a domestically purchased executive liability program, experts said any private or nonprofit firm that regularly conducts business with entities or individuals overseas should carefully consider buying locally admitted coverage as well. Directors and officers of private companies and nonprofit organizations are generally less exposed to securities law than public companies, but a wide range of overseas rules and regulations could still translate to litigation either in the United States or abroad.

Private and nonprofit insurance buyers that do approach the D&O market in 2012 will find it "in transition," according to several

experts. For most privately held and nonprofit organizations, D&O insurance and other companion policies are likely to remain affordable and fairly broad in terms of covered risks in the coming year, but the deep discounts on new premiums and double-digit percentage drops on renewal rates of the last six to seven years are proving unsustainable. As a result, some carriers have indicated they will take a stricter approach to placing and renewing D&O coverage for private firms this year, especially small and middle-market firms.

Though some purchases and best practices cut across all sectors of private and nonprofit business, all insurance policies are not created equal. The particulars of an effective executive risk management program can vary significantly based on industry, business model and the person ultimately responsible for procuring the coverage. Most D&O programs marketed to private and nonprofit firms are included as a package benefit with employment practices liability, fiduciary or fidelity insurance, or a combination of all three. However, even seemingly minor differences in policy terms and conditions can dramatically alter the scope of coverage.

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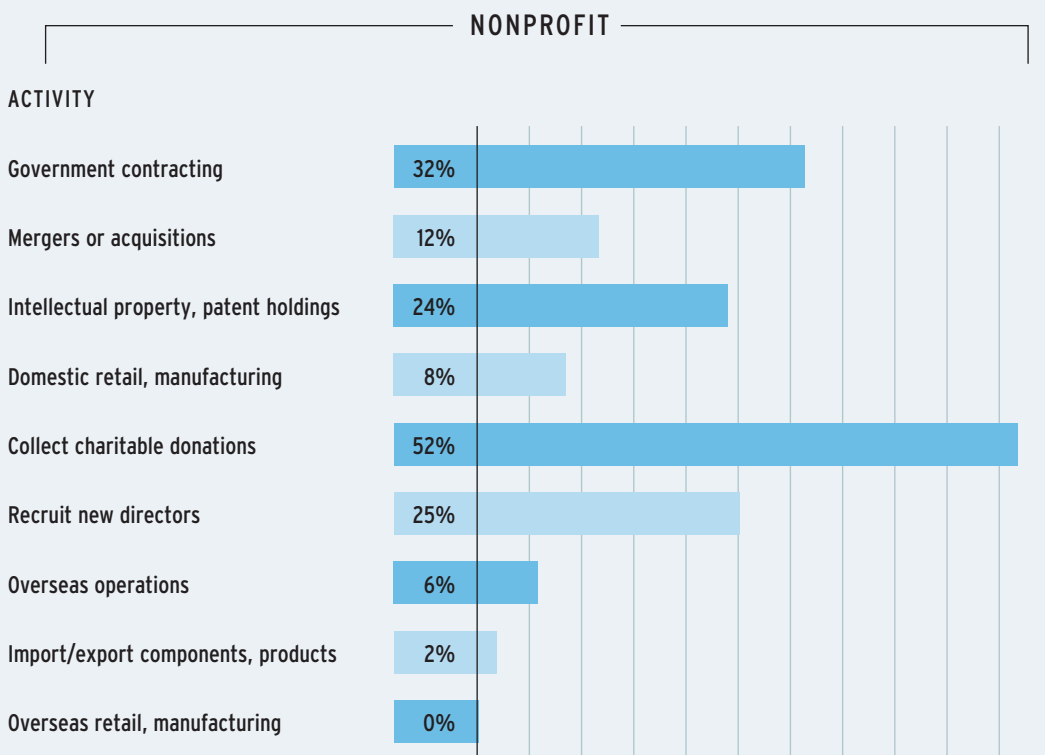
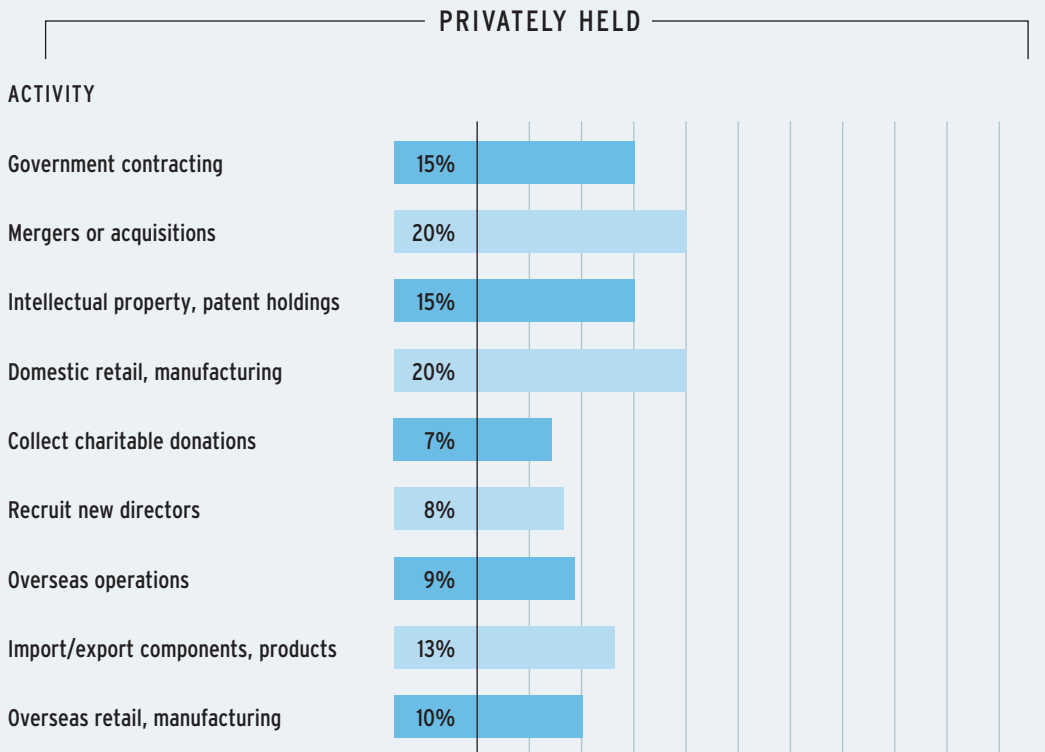
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## RISKY BUSINESS

Activities done by privately held and nonprofit firms that could lead to a D&O claim, by percentage of respondents.\*



\*Multiple responses were permitted.

Source: BI survey

## Risks: Research measures D&O purchasing habits

CONTINUED FROM PAGE 4

For nonprofits, the leading potentially risky business activities included collecting charitable donations, government contracting, recruiting new directors, possession of intellectual property and/or patent holdings, and mergers or acquisitions.

Although the survey showed that about three-quarters of both private companies and nonprofit organizations purchase some D&O coverage, it also revealed that only about half are buying complete coverage for directors, officers and the entity as a whole.

### ABCs

Of privately held companies purchasing D&O coverage, 29% purchase only Side A coverage, which indemnifies individual directors and officers, while just 22% buy both Side A and Side B coverage, which includes reimbursement to the entity for indemnification payments made to directors and officers. Slightly more than half—58%—buy Sides A, B and C, which includes entity coverage.

Private companies and nonprofit organizations also are more likely to also purchase crime and fidelity, EPL and fiduciary liability coverage, the survey found.

Of privately held companies purchasing D&O coverage, 29% purchase only Side A coverage, which indemnifies individual directors and officers, while just 22% buy both Side A and Side B coverage, which includes reimbursement to the entity for indemnification payments made to directors and officers. Slightly more than half—58%—buy Sides A, B and C, which includes entity coverage.

Of the nonprofit organizations purchasing D&O coverage, 27% buy Side A; while 23% buy Sides A

and B; and 55% buy Sides A, B and C.

When asked whether they purchase other management liability coverage in conjunction with D&O, 60% of privately held firms and 72% of nonprofits said they also buy crime and fidelity coverage. Additionally, 64% of privately held firms and 60% of nonprofits purchase EPL coverage, while 62% of privately held companies and 63% of nonprofits buy fiduciary liability coverage.

A significant percentage of survey respondents—10% of privately held companies and 8% of nonprofit organizations—admitted ignorance about the structure of their insurance policies or their coverage limits.

Moreover, of the respondents that said they did not purchase any D&O coverage at all, 10% of private companies said they didn't know why.

Asked why they forgo the coverage, 48% of private companies and 80% of nonprofits said they didn't need it, with 15% of privately held firms and 10% of nonprofits saying they believe their D&O risks are covered under their other liability policies.

Thirty percent of privately held firms said they self-insure their D&O exposure, compared with just 5% of nonprofit organizations.

D&O coverage limits varied, with 21% of privately held firms buying less than \$5 million; 22% buying \$5 million to \$10 million; 16% buying \$10 million to \$25 million; 14% buying \$25 million to \$50 million; 15% buying \$50 million or more; and 10% saying they weren't certain how much coverage they were buying.

Meanwhile, 24% of nonprofit firms said they buy less than \$5 million in D&O insurance coverage; 27% said they purchase \$5 million to \$10 million; 10% said they purchase \$10 million to \$25 million; 12% buy \$25 million to \$50 million; and 20% buy \$50 million or more. Seven percent of respondents from nonprofit organizations said they were not sure how much coverage they purchase.

## How survey of D&O risk awareness, buying habits was conducted

*Business Insurance's* inaugural survey of directors and officers liability risk awareness and insurance buying habits included responses from 772 individuals involved in insurance purchasing decisions at their firms.

The survey was conducted during December 2011 by Signet Research Inc., a Cliffside Park, N.J.-based independent research company, which sent email solicitations to 15,031 *Business Insurance* readers.

Among those who responded, 48% held risk management positions in their organizations, while 33% were chief executives. Additionally, 9% held CFO or other finance positions; 7% were in corporate management; 2% were in human resources; and 1% served as general counsels.

Privately held organizations represented 56% of respondents, followed by public companies, which made up 20%; nonprofits, making up 13%; and

governmental entities, 10%.

Nearly half—49%—of the companies surveyed reported total annual 2010 revenues of \$100 million or less; 17% had revenues between \$100 million and \$500 million; 8% had revenues between \$500 million and \$1 billion; 12% had revenues between \$1 billion and \$3 billion; and 14% had revenues exceeding \$3 billion.

Fifty-five percent of the respondents' firms had fewer than 1,000 employees;

21% had between 1,000 and 4,999 employees; 8% had between 5,000 and 9,999 employees; and 16% had 10,000 or more employees.

The top five industries represented by survey respondents were finance and insurance, 31%; manufacturing, 12%; health care and social assistance, 10%; professional, scientific and technical services, 6%; and educational services, 6%.

—By Joanne Wojcik



# We created an insurance policy for a 64-story thrill ride. Boy, was that fun.

The Chicago World's Fair was planned during the peak of the 1920s but didn't roll out until the height of the Great Depression. And Zurich wanted to help make sure that nothing would prevent the "Century of Progress" from moving forward. The risk possibilities were considerable, so we worked with city officials to help reduce hazards and minimize risk. During its two-year run, the expo attracted a record 39 million people and brought \$200 million to the city of Chicago. It can be said that the 1933 World's Fair gave hope to the nation. And we couldn't be more proud to have been a part of it. **Insuring success since 1912. Visit [zurichna.com/100](https://zurichna.com/100)**



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# Opinions

## EDITORIAL

## Health reforms bring D&O risk

**T**he health care reform law is leading to all kinds of unexpected consequences as the government, regulators, and public and private organizations assess and try to deal with the massive changes the law will bring.

Numerous knock-on effects have arisen out of the law, such as employers reassessing whether they will offer health care benefits and corporate benefits costs increasing as employers are, for example, required to offer coverage to more of their employees' adult children.

One less prominent effect of the law is the way a cost-cutting provision will increase the liability exposure of directors and officers of some health care organizations.

As hospitals, health care systems and other medical providers combine to form accountable care organizations under a provision in the health care reform law, they should achieve economies of scale—but they also may be opening themselves up to D&O-related liabilities.

As we report on page 18, forming or joining ACOs will offer health care organizations the ability to receive bonus payments from Medicare and private payers for improving quality and lowering medical costs through better care coordination.

A liability concern that has arisen as a result of the provision is the potential for ACOs to be targets of antitrust allegations. For example, health care providers left outside of the ACOs may feel that their ability to compete is compromised, especially in rural areas with small populations, and sue the ACOs.

Obviously, liability lawsuits are not new to health care providers, and they usually have sufficient insurance coverage in place to cover damage awards. The structure of ACOs, however, could mean that any D&O coverage the individual member organizations have in place may not be sufficient to cover the ACOs exposure, or that any claim or settlement will lead to complex arguments over which D&O policy should respond.

While the intention of the law was to expand health care coverage, the law also is expanding the universe of liabilities that health care-related firms have to deal with. Their executives and risk managers should act now to address those issues before the claims come rolling in.

## LETTERS

*Business Insurance* welcomes letters to the editor.

The section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters.

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## SCHILLERSTROM



## COMMENTARY

## Don't get caught off guard by risks

**A** lawsuit has just been filed against your private or nonprofit organization, accusing the firm and several top executives of mismanagement.

Your first reaction is to hand the suit over to your commercial general liability insurer, but the claim is denied because corporate officers are named. CGL coverage primarily responds to claims for bodily injury and property damage, but not to those involving directors and officers liability.

D&O claims can do considerable harm to a private or nonprofit organization of any size in practically any industry. In fact, because private company directors and officers are often involved in day-to-day operations and decision-making, they are more likely than public company board members to be named in lawsuits initiated by employees, customers, competitors and regulators. Shareholders of privately held companies also frequently sue directors and officers for inadequate or inaccurate disclosure in financial reports and statements made in private equity placement materials.

Despite these risks, one in four private and nonprofit firms does not purchase D&O liability coverage, a survey commissioned by *Business Insurance* found. Moreover, even though a sizable majority of private and nonprofit companies—71% and 74% respectively—do attest to having some form of D&O coverage, the survey revealed that they may not be buying the right kinds of protection.

Additionally, a significant proportion of survey respondents—10% of privately held companies and 8% of nonprofit organizations—admitted ignorance about the structure of their D&O policies or coverage limits.

*Business Insurance's* survey also showed that privately held and nonprofit firms may not be adequately assessing their D&O risks.

Employment practices litigation was the No. 1 source of D&O claims among the survey respondents, yet only half of nonprofit firms and 38% of private companies listed it as a top concern. Instead, more private and nonprofit companies listed regulatory litigation and lawsuits filed by customers or competitors as top concerns, even though claims filed among the respondents was much lower in both categories.

Perhaps most alarming was the fact that 15% of privately held firms and 10% of nonprofits actually believed that one of their other insurance policies would respond to a D&O claim, making the scenario I just described not so far-fetched.

Private and nonprofit D&O coverage is essentially an all-risks management liability policy written on a duty-to-defend basis. As such, with the right companion coverages, it can pay for the legal defense of virtually any allegation of corporate mismanagement, including violations of fiduciary duties related to employee benefit plans, discriminatory employment practices, and even employee theft and dishonesty. In some cases, D&O policies even provide coverage for malicious computer hacking.

D&O insurance can be a very important risk management tool for middle-market privately held and nonprofit firms. It almost seems as if directors and officers who don't buy the coverage are violating their fiduciary duties to themselves and to their organizations.

Contact: [jwojcik@businessinsurance.com](mailto:jwojcik@businessinsurance.com)



**JOANNE  
WOJCIK**  
SENIOR EDITOR

# Perspectives

New 401(k) fee disclosure rules promulgated by the U.S. Labor Department and a landmark U.S. Supreme Court ruling have the potential of increasing lawsuits against directors and officers alleging that they violated their fiduciary obligations.

## Fiduciary risks evolving at private, nonprofit firms

By **PATRICK F. MORAN**

**A**s most directors or officers of private or nonprofit institutions are keenly aware, the potential liabilities that come with the job are usually not what were expected, whether serving as president of a multimillion-dollar corporation or volunteering on the board of a local charity. Claims made against directors and officers are a perplexing and scary topic for the unaware.

Recently, we have seen an increase in a subset of claims against directors and officers pertaining to their fiduciary obligations. In particular, the rise of breach-of-fiduciary-duty claims made by 401(k) participants whose plans have lost value is a thorny issue for directors and officers, with good reason.

Since the United States Supreme Court's 2008 decision in *LaRue vs. DeWolff, Boberg & Associates Inc.*, individual 401(k) plan participants can file suit alleging breach of fiduciary duty claims for underperforming plans. After an initial administrative process, individual 401(k) participants can allege a valid "stock drop" complaint against the directors and officers of the plan for fiduciary breaches that resulted in the loss of value in their individual 401(k) accounts. These suits are particularly common where the company's own stock is an investment choice under the 401(k) plan. Since the Supreme Court's decision, there has been a rise in the number of actions in federal district court by individual participants seeking recompense from the directors and officers of their 401(k) plans.

The fiduciary duties that the directors and officers allegedly breach in these cases are varied. The customary allegations include that directors and officers misrepresented facts; failed to avoid conflicts of interest; failed to monitor plan investments for risk and take steps to prevent loss

to the plan; and failed to diversify investments so as to minimize the chance for loss. In other words, plaintiffs have developed an extensive and growing list of accusations against directors and officers for events likely out of their control.

Making matters more complex for private and nonprofit directors and officers, recent court cases allege that the payment of excessive fees charged by 401(k) plan administrators can be breach of fiduciary duty by the directors and officers of the



Mr. Moran

sponsor. Just last month, Bentonville, Ark.-based Wal-Mart Stores Inc. and New York-based Merrill Lynch & Co. Inc. (now a subsidiary of Bank of America Corp.) agreed to a \$13.5 million settlement in a class action lawsuit alleging that the company and its retirement plan administrator breached their fiduciary duties by failing to negotiate lower fees for 401(k) participants.

Under Labor Department regulations that take effect in 2012, 401(k) plan sponsors will be required to perform due diligence concerning fees and then ultimately fully disclose all fees associated with their given plan. This requirement likely will be an eye-opening experience for plan sponsors and participants alike, who oftentimes are not aware of fees asso-

ciated with their 401(k) plans. Many 401(k) plans contain complex fee structures, and the new disclosure requirements likely will lead to claims made against the directors and officers of the plans whose fees are alleged to be excessive. These new disclosure requirements are likely to be a source of frequent litigation that may trigger fiduciary duty coverage under the typical directors and officers liability insurance policy.

Thankfully, not everything a director or officer does is going to lead to liability, even if an initial claim can be made. Directors and officers are still able to defend against fiduciary duty claims by asserting good faith and safe harbor provisions of federal law. The new 401(k) fee disclosure requirements also provide immunity for directors and officers if they reasonably and in good faith rely on the information supplied by a service provider, usually the third-party administrator. However, as any director or officer who has been accused of breaching a fiduciary duty can attest, a valid defense is not a cure-all for the costs and risks associated with asserting it.

In today's economic environment, where many private companies and nonprofits are facing financial difficulties, the need for quality D&O insurance is critical.

Particularly when the directors and officers sponsor a 401(k) plan, it is crucial for private companies and nonprofits to be aware that quality D&O liability policies can include fiduciary liability coverage, thereby minimizing the exposures that they may face.

*Patrick F. Moran is senior counsel at Gordon & Rees L.L.P. who is based in Chicago. He frequently represents entrepreneurs and management on issues of fiduciary duty and duties of good faith and fair dealing. Mr. Moran additionally represents employers in employment practices litigation.*

**In today's economic environment, where many private companies and nonprofits are facing financial difficulties, the need for quality D&O insurance is critical.**

# Regulatory risks differ by industry

Wide range of laws affect private firms, nonprofit groups

By JUDY GREENWALD

Privately held and nonprofit companies have a full plate of potential regulatory risks that could result in directors and officers claims, but observers say much depends on the particular industry in which a company operates.

Federal and state agencies "are more and more concerned about individual directors and officers liability," particularly for private for-profit companies, "generally in cases where a business may fail for whatever reason, and the regulators feel as if there needs to be a point made," said Patrick F. Moran, senior counsel at Gordon & Rees L.L.P. in Chicago.

"We've not seen as much on the nonprofit side, but certainly there's nothing stopping it," Mr. Moran said.

Warren W. Stippich Jr., a partner with Grant Thornton L.L.P. in Chicago who sits on the board of an unnamed nonprofit organization, said it is important for board members to have D&O coverage because "you are putting yourself at risk by stepping into a governance oversight fiduciary role."

Laws that could affect these organizations' D&O coverage include the Americans with Disabilities Act, the Foreign Corrupt Practices Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act and antitrust laws, to name just a few.

While the U.S. Securities and Exchange Commission focuses more on publicly traded companies, there are some instances

when firms should be concerned about SEC regulatory action also (see related story).

Many risks depend on the industry in which the privately held firm or nonprofit operates.

Gregory Husisian, of counsel at law firm Foley & Lardner L.L.P. in Washington, who focuses on cross-border issues, said private companies have a "very similar risk profile" to publicly traded companies.

"With only a few exceptions, usually it's not the way the company is organized" that is important, said Mr. Husisian. Rather, the risk profile is determined "by where they operate, what kind of products they sell, their business mode." Another factor is whether companies use consultants or third parties for whom a company may be held responsible, he said.

D&O liability is a particular concern for regulated industries, which include energy, financial institutions, utilities, telecommunications and governmental entities, as well as firms that have public debt, said Deneen Schmitt, Pittsburgh-based senior vp of FINEX North America, a unit of Willis North America.

Antitrust "is a huge issue" for private companies, said Donna Ferrara, senior vp and managing director at Gallagher Management Liability Practice Group in Chicago.

Antitrust concerns could involve the Federal Trade Commission if the firm is involved in some kind of a trade, or the Federal Communications Commission if it is in communications, Ms. Ferrara said.

In addition, "the jury is still out" on Dodd-Frank, which "is an enormous bill" that calls for "hun-

## Private companies could see SEC action

There are circumstances under which companies that are not publicly traded still have to worry about regulatory actions by the U.S. Securities and Exchange Commission, observers say.

David E. Longenecker, a member of law firm Stites & Harbison P.L.L.C. in Lexington, Ky., said when a private company, its officers or its directors are buying or selling its own shares, certain matters affecting the firm in connection with the trade require disclosure under federal law.

"You can't completely eliminate any SEC concerns," said Joseph Monteleone, a New York-based partner with the Tressler L.L.P.

Observers say an example is a lawsuit filed by the SEC last month against Coral Gables, Fla.-based Stiefel Laboratories Inc., a dermatology product maker that Brentford, England-based GlaxoSmithKline P.L.C. acquired in 2009 for \$2.9 billion.

According to the lawsuit filed in federal court in Miami, privately held Stiefel Labs and

Charles W. Stiefel, its chairman and CEO, did not disclose "material, nonpublic information" that would have affected the value of the company's stock.

For example, in the period leading up to the acquisition, the company repurchased stock from current and former employees, who owned it through its employee stock bonus plan, for \$16,500 a share while it was negotiating the company's sale for more than \$68,000 a share, according to the suit.

"Stiefel Labs' stock did not trade on the public markets, so the company's purchases were essentially the exclusive way for current and former shareholders to liquidate their Stiefel Labs stock," according to the suit.

The litigation accuses the defendants of fraud and aiding and abetting violations of the Securities Exchange Act. Among other things, it seeks the return of all "ill-gotten" profits or proceeds resulting from its violations as well as civil penalties.

—By Judy Greenwald

### MINIMIZING LIABILITY

Steps to take to reduce potential D&O liability include having:

- Comprehensive risk analysis
- Strong compliance programs
- Strong training procedures
- Good communications channels with senior management and board of directors.
- Someone with compliance ownership

go-based assistant vp of management liability for Liberty International Underwriters, said employment practice liability issues, including those involving charges of discrimination and wrongful termination, "account for 85% to 90% of the claims that we see" among nonprofits.

In the international realm, Mr. Husisian said the U.S. government is focusing on the Foreign Corrupt Practices Act. In addition to publicly traded companies, private firms and nonprofits are subject to the FCPA's anti-bribery provisions, although not to its book-keeping and internal controls provisions.

Complying with the FCPA would be "equally hard" for a private or nonprofit firm as it would be for a public company if it operates in high-risk areas such as China or parts of the former Soviet Union, Mr. Husisian said.

Other areas of international concern include the Export Administration Regulations, which relate to the control of certain exports and implement anti-boycott law provisions. The regulations are issued by the U.S. Commerce Department's Bureau of Industry and Security.

Also applicable could be the International Traffic in Arms Regulations, which relate to the export and import of defense equipment and services and are administered by the U.S. State Department.

States add another layer of regulatory concern.

"Different states will have different regimes that are possibly overseeing nonprofits," said Alan A. Rudnick, Richmond, Va.-based partner of corporate governance consulting firm Masters-Rudnick & Associates L.L.C.

Mr. Weber said it is common for D&O policies to exclude regulatory fines and penalties, although defense costs, including investigations, typically are covered.

Joseph Monteleone, a New

York-based partner with the Tressler L.L.P. law firm, said underwriters view private and nonprofit organizations as having "somewhat of a diminished risk compared to the public side."

However, private firms also buy much less insurance coverage than their public counterparts and may not buy adequate coverage, Mr. Monteleone said.

"Particularly in the nonprofit area, most people don't even think twice about their liability" because they are acting as volunteers, Mr. Moran said. As a result, there is a "tremendous amount" of underbuying of insurance.

Mr. Husisian said steps companies should take to minimize their potential D&O liability include conducting a comprehensive risk analysis "to determine where their problems are and where issues are likely to arise." Firms also should have strong compliance programs "and set up common-sense procedures that are administrable and that will work for the company" and have strong training procedures in place, he said.

Also, identify the people who are most likely to encounter the issues involved and make sure they are knowledgeable about the company's procedures and the laws' provisions, he said.

"Set up good communications channels with senior management and any board of directors so the company has someone who's monitoring the compliance and is aware of it at the very highest levels" of the organization, said Mr. Husisian.

The company also needs to designate someone within the company who has "ownership of the compliance arena," such as a chief compliance officer or the head of human resources if it is a smaller organization.

This should be someone "who's independent of business pressures" and does not have to worry, for instance, about getting a quarterly bonus.

## FEDERAL REGULATIONS

A wide range of laws and regulations affect private and nonprofit companies at the federal, state and local levels, experts say. Federal laws include:

- Americans with Disabilities Act, and other laws regulated by the Equal Employment Opportunity Commission
- Foreign Corrupt Practices Act
- Dodd-Frank Wall Street Reform and Consumer Protection Act
- Various anti-trust laws
- Export Administration Regulations, issued by the U.S. Commerce Department's Bureau of Industry & Security
- International Traffic in Arms Regulations, administered by the U.S. State Department
- Internal Revenue Service regulations
- Department of Labor regulations
- Federal Trade Commission regulations
- Federal Communications Commission regulations
- Securities and Exchange Commission regulations

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# D&O coverage can kick in when business gets dirty

## Anti-competitive lawsuits rising in middle market

By **RUSS BANHAM**

In the roughneck world of business, it's easy to hate the competition. Just keep it to yourself.

Several legal and insurance industry observers say there has been an increase in the willingness of private companies and nonprofit organizations to sue their competitors for slander, defamation of character and comments disparaging their products or services. On top of these lawsuits are others alleging the theft or infringement of intellectual property, trademarks and patents.

Sometimes these suits target the organization and its directors and officers. Making matters worse is that the directors and officers may not be covered by insurance for the anti-competitive actions.

"This sort of 'business dispute' issue is definitely one in which we're seeing an increase in activity," said Michael Schraer, not-for-profit product manager at Warren, N.J.-based Chubb Corp. "As a result, D&O policies are evolving to address this rising exposure."

Because private and nonprofit enterprises often settle such matters privately, scant evidence exists on the frequency and severity of these claims. Nevertheless, Jim Donovan, senior vp of professional liability with New York-based Liberty International Underwriters USA, agreed that such lawsuits are "a growing threat."

"As we move more from a manufacturing economy to one where businesses sell expertise and services, there is a greater likelihood for professional liability," Mr. Donovan said.

And "directors and officers of private and

nonprofit firms can be sued by third parties, even though they do not owe fiduciary duties to third parties," said Dan Bailey, a partner at Bailey Cavaleri L.L.C., a Columbus, Ohio-based law firm specializing in D&O litigation.

Why does there appear to be an increase in alleged anti-competitive activities?

One factor may be the general economy.

**'If you defame a competitor or slander a company's product, the CGL policy has an advertising and personal injury section that covers libel and slander, but only if the organization is manufacturing-based.'**

Jim Donovan,  
Liberty International Underwriters USA

"Everyone is scrapping for traction in the marketplace, as opportunities to succeed become fewer," Mr. Schraer said. "At the same time, executives may leave one private firm for another for financial reasons. Suddenly, the former employer is now a competitor. The executive has proprietary insight, trade secrets, customer lists or other inside information about the prior organization that he or she then passes on to the new firm, which tips the competitive scales in its favor. The consequence is a lawsuit."

Antitrust claims also are rising in the

nonprofit space, particularly among trade associations and professional societies, Mr. Schraer said.

"Say an association provides some sort of certification or accreditation to members," he said. "An association of cattle breeders might provide a certification for Black Angus beef. It decides that a member—cattle rancher No. 62—no longer qualifies for the certification, which results in the company's competitive disadvantage. The rancher may sue the association's directors and officers, arguing it deserved certification."

A similar scenario plays out with respect to slander, defamation and similar derogatory comments. A board director of a private company who makes a negative public comment about the CEO of a competing company may be sued if the remark causes the competitor's business results to falter.

There are two legal theories that plaintiffs can leverage in this context, Mr. Bailey said. The first is a statutory violation that creates a private right of action, such as a violation of antitrust laws or statutes governing intellectual property and unfair trade practices. The second is "tortious wrongdoing," or the commission of a tort.

While directors and officers are likely to be covered for these exposures by their firms' professional liability insurance, commercial general liability and D&O policies, there are nuances to consider.

"If you defame a competitor or slander a company's product, the CGL policy has an advertising and personal injury section that covers libel and slander, but only if the organization is manufacturing-based," Mr. Donovan said. "If the firm sells expertise and services but not a product, typically a CGL will exclude professional liability. In effect, you're not covered."

Picking up this financial exposure would be miscellaneous professional liability insurance, which addresses slander and

defamation risks, in addition to copyright and trademark violations. Yet another nuance: The policy does not absorb patent infringement risks, requiring a stand-alone policy for this additional exposure.

With regard to D&O insurance, patent infringement risks again "are the least likely to be covered—there's either an absolute exclusion or something very close to that because of the high-risk exposure," Mr. Schraer said. "The theft of trade secrets also is likely not to be covered and would require a stand-alone policy."

He added that the greater the exposure, the greater the likelihood of it being excluded, sublimited in the D&O policy or included at much higher premium.

Avoiding a claim alleging anti-competitive behavior includes the obvious—but-toning one's lips.

"Common sense is the best practice," Mr. Bailey said. "Obviously, one should refrain from saying anything about a competitor or a competing product that is known to be false or misleading. One should not copy a competitor's product and create confusion in the market regarding competing products. If a competitor has created intellectual property rights, one should be very careful to avoid even the appearance of interfering with those intellectual property rights."

He added, "As a general matter, is it much safer to tout your own products rather than disparage a competitor's product?"

Making sure directors and officers are aware of the exposures they confront is another best practice.

"They need to know there are certain things they can talk about when they get together with competitors, and certain things they cannot talk about," Mr. Schraer said. "Even if the intent was not anti-competitive, it can still cause liability."

Mr. Donovan advised directors and officers to ask risk managers if anti-competitive exposures are covered by insurance, and which policies apply.

"The intent of D&O insurance is not to pick up professional liability—that's typically the province of errors and omissions insurance," he said. "You would then want to view the E&O policy's definition of wrongful acts to ensure it provides coverage."

Because even the best loss-prevention tactics will not completely prevent such claims from being filed, comprehensive insurance coverage is vital. "Broader coverage addressing nonofficer employees may be needed, for instance, because these types of claims can also be brought for actions by a nonofficer employee," Mr. Bailey said.

Another consideration has to do with whether "entity coverage" is provided within the D&O policy. In such cases, individual insureds could have their available limits of liability eroded by losses the company incurs. To reduce the risk of leaving the directors and officers without coverage, Mr. Bailey recommended that the policy contain a "priority of payment" provision requiring the insurer to pay individual insureds' losses first.

Finally, the company should consider buying Side A coverage excess of the standard D&O insurance policy.

"Although public companies routinely purchase Side A policies, relatively few private and nonprofit firms purchase it, even though that type of policy can provide important protection for individual insureds," Mr. Bailey said.

There is another compelling reason to buy Side A.

"Many private and nonprofit D&O policies contain broad antitrust and intellectual property exclusions," Mr. Bailey said. "It's difficult to remove these exclusions entirely, hence the need to consider a Side A carve-out to the exclusions so the individual insureds have coverage."



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**'A bankruptcy increases the threat of personal financial liability for directors and officers because a bankrupt organization may not have the ability to indemnify for defense costs, settlements or judgments. If executives are sued, the entity may not be there to protect them.'**

Carol Zacharias, ACE North America



# Bankruptcy filings heighten D&O exposures

## *Personal financial wealth threatened by lawsuits*

By **RUSS BANHAM**

The number of bankruptcy filings fell in 2011 despite some high-profile failures, according to statistics provided by the U.S. Bankruptcy Courts.

What has not fallen, however, is the dire risk a bankruptcy poses to a private company's directors and officers.

It is virtually certain that litigation against directors and officers will arise in the immediate wake of a Chapter 11 or Chapter 7 court filing for bankruptcy protection. After all, someone is responsible for the failure, and that someone typically is the board and senior management.

These suits pose enormous risks to the personal financial wealth of the directors and officers, even with standard D&O insurance.

"A bankruptcy increases the threat of personal financial liability for directors and officers because a bankrupt organization may not have the ability to indemnify for defense costs, settlements or judgments," said Carol Zacharias, senior vp deputy general counsel at insurer ACE North America based in Philadelphia. "If executives are sued, the entity may not be there to protect them."

When a petition for bankruptcy is filed, this creates a bankrupt estate comprising the assets of the bankrupt entity. Once the petition is filed, no litigation can commence against the bankrupt estate, and an automatic stay is imposed on any proceedings against the assets of

the bankrupt estate.

But are the proceeds from the entity's D&O policy an asset of the estate and, therefore, subject to the automatic stay? "If the court rules affirmatively, then, absent permission of the bankruptcy trustee or court, the directors and officers cannot get at the proceeds to provide them reimbursement for defense costs, settlements or judgments—when they most need these proceeds—because they cannot rely on corporate indemnification," Ms. Zacharias said.

Although final figures are still being put together on the extent of business bankruptcy filings in 2011, early indications point to a slight year-over-year decrease. Not that the decreasing number of failures is something to celebrate—they're still sky-high by comparison with pre-Great Recession tallies.

According to aggregate figures provided by U.S. Bankruptcy Courts, 36,540 businesses filed for Chapter 7 bankruptcy protection and 10,830 filed for Chapter 11 through the end of June 2011. This compares with 15,268 businesses that filed Chapter 7 and the 5,046 that filed Chapter 11 through the first six months of 2007. The math indicates a rate of failure that is more than double what it previously was.

Given persistent economic uncertainty, the outlook in 2012 is for much of the same. What has changed, however, is the inclination among affected parties like creditors to sue directors and officers.

"Ten years ago, we didn't see much in the way of litigation against directors and officers of a bankrupt company, simply because the filing wasn't viewed as neces-

sarily a bad thing," said Ann Longmore, executive vp and D&O practice leader at Willis North America in New York. "The odds were that you wouldn't get sued."

This view extended to private companies and nonprofit organizations. "Five or six years ago, we'd have owners of private companies tell us they buy all coverages except D&O insurance, because they didn't have a D&O exposure," said Michael Kosednar, assistant vp and private company management liability product manager at insurer The Hartford Financial Services Group Inc. "This is no longer the case."

Ms. Longmore agreed. "Creditor committees and trustees are increasingly aggressive," she said. "They'll try to go after the directors and officers, and you don't want to be in bankruptcy court. The courts are not going to be sympathetic to the people who ran the company into the ground."

Not only must private companies and nonprofit enterprises consider buying D&O insurance, they need to be cognizant of the D&O policy language and the coverage terms and conditions.

In particular, the observers pointed to the need to insert a "priority of payments" provision in the D&O policy. "The objective is to show that the insureds and insurer intended that the policy benefit the directors and officers first, and in this regard will pay their losses prior to paying the entity's losses," Ms. Zacharias said.

Another useful piece of advice concerns presumptive indemnification provisions, a clause found in most D&O policies. It states that in a claim situation, it is presumed that the corporate organization has indemnified its directors and officers to

the fullest extent permitted by law, regardless of whether the corporation does, in fact, indemnify the directors and officers. The provision is significant because the typical D&O policy includes a substantial self-insured retention for corporate reimbursement—Side B—coverage, but little or no retention for "direct"—Side A—D&O coverage.

Why is this important? "In a corporate bankruptcy situation, directors and officers can be personally exposed without the protection of promised indemnification," said Ms. Zacharias. "Consequently, when purchasing the D&O policy, ensure that you have an exception to presumptive indemnification for bankruptcy or financial impairment. In addition, ensure that the Side A retention is low, if not zero, since it will be borne by individuals. By taking these two steps, you provide greater coverage protection for the directors and officers."

One final piece of advice addresses the wisdom of purchasing a Side A D&O policy as an excess policy with a difference in conditions, or DIC, feature covering solely the directors and officers. This way, if the underlying A, B and C D&O policies are subject to an automatic stay, the excess Side A coverage can be availed.

"Some Side A policies are written for coverage to commence and payments to be made before the A, B and C D&O policies, if there are any problems with regard to the bankruptcy court holding up the ABC policy proceeds," said Carolyn Polikoff, corporate and executive protection practice leader at San Francisco-based broker Woodruff-Sawyer & Co. "At the very least, it's a measure of comfort."



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# Family businesses face unique D&O exposures

## Generational changes add potential liabilities

By ROSEANNE WHITE GEISEL

A family business is not safe from lawsuits against directors and officers, and executives in family businesses must realize they face directors and officers liability risks just as executives of other private and public companies do, observers say.

"One of the biggest pitfalls (for family businesses) is that they feel their exposure is low," said Larry Racioppo, director of consultant Towers Watson & Co.'s executive liability practice in Stamford, Conn. "Claims of one family member against another are far too common."

Chad Berberich, senior vp with specialty insurer RLI Corp.'s executive products group in Dallas, said issues such as hiring and succession "are amplified when you bring in the family dynamic."

The priority issues for midsize family-owned businesses, according to Brock Lewark, vp with Lockton Financial Services in Kansas City, Mo., a unit of broker Lockton Cos. L.L.C., are "protection of family wealth and maintaining the wherewithal of the business going forward."

Keith Lavigne, senior vp and national practice leader for the private and nonprofit division of ACE Professional Risk, a unit of ACE Group, in New York, said it boils down to this: "The first generation builds the business, the second generation appreciates what has been built and continues the mission. By the time you get to the third or fourth generation, those shareholders may not value the mission in itself."

Additionally, Mr. Lavigne said, those later generations may not work in the business, so they may question transactions or want to restructure control of the company.

Problems also can arise with relatives whose only involvement in the business is owning shares in a trust, Mr. Lewark said. "If the trust loses value, that could be a claim," he said.

Claims also can be generated by employee stock ownership plans, because members must be bought out of the ESOP, and by ownership transfer after a merger or acquisition, Mr. Lewark said. Minority shareholders who are not family members may not agree with management decisions, and they may perceive that the family is putting its interests before those of other shareholders, he said.

"The big elephant in the room" when there are employees outside the family, is the potential charge of nepotism in hiring, promotion or compensation, according to Glen Bailey, managing director, executive liability practice, of Atlanta-

based brokerage Beecher Carlson Holdings Inc.

Subtler issues also exist. Sometimes employees who are not part of the family are afraid to offer objective opinions, to the company's detriment, Mr. Bailey said. A family business also may find it hard to lure effective board members, he said. Those situations could lead to bad decisions that could generate D&O claims.

Dick Clarke, senior vp of the executive protection practice for broker J. Smith Lanier in Duluth, Ga., said it is important to remember that D&O liability "goes well beyond shareholder litigation."

Suits can arise from competitors, customers and employees, regulatory agencies and suppliers, experts say.

For that reason, brokers and insurers must "look beyond standard policies to a family business' specific D&O situation," Mr. Clarke said.

Not having "the right breadth of coverage and the right limits and the right retentions based on size and exposure" is another pitfall for midsize family-owned businesses, said RLI's Mr. Berberich.

Shelley Norman, Chartis Inc.'s Chicago-based head of private and nonprofit management liability for financial lines in the U.S. and Canada, said family-owned businesses "must identify the exposures that are important to address," then identify the coverage that's most important and the retention the business is able to bear.

Employment practices liability, said Lockton's Mr. Lewark, "is one of the largest exposures that a family-owned business has."

Family-owned businesses must decide whether EPL coverage should be attached to the D&O policy, whether D&O should be added to EPL coverage, or whether they should be separate. Another key question is whether a D&O package should have an aggregate limit or separate limits.

It also is vital to ensure that coverage exclusions are not too broad to meet the business' needs, experts say.

"It's not as if you buy EPL and get D&O free, but it's almost that way," said Lanier's Mr. Clarke. An EPL buyer can

add D&O coverage for an added premium increase of between 10% and 15%, he said.

"Ultimately, EPL is a frequency exposure for employers of all sizes. D&O is a severity exposure," Mr. Clarke said.

After EPL, crime or fiduciary coverage generally is the next biggest D&O need, brokers and insurers say. Mr. Clarke said fiduciary liability coverage is important now amid uncertainty about 401(k) plans and employee benefits.

Once the coverage is determined, pay attention to exclusions. Mr. Lewark said in the competitive insurance market, traditional insured vs. insured and family claims exclusions have been narrowed by exceptions. For example, refusal to indemnify is an exception to the insured vs. insured exclusion. And make sure the duty to defend is clear, said Towers Watson's Mr. Racioppo.

Whether to have aggregate or separate limits in a D&O package depends upon the structure of the program; whether there is stand-alone Side A D&O coverage, which indemnifies individual directors and officers as opposed to the corporate entity; and the D&O limits, said Mr. Bailey of Beecher Carlson. "I don't know if it makes a whole lot of sense" to aggregate limits to save 15% on premiums, Mr. Bailey said, and "possibly diluting the D&O coverage because of another" type of related claim.

Mr. Racioppo said modular policies now are offering an option for network security and privacy coverage. He offers

this caution: "It's a bad idea to have your network security wrapped up in your aggregate limits. You don't want issues surrounding data breach to erode limits available to directors and officers."

Mr. Clarke advises that a family business should clearly define and understand its structure.

And executives of a family-owned company must accept that because shareholders may have different emotional attachments to the company, conflicts arise that are out of their control.

Directors and officers should "focus on the things they can control," said Chartis' Ms. Norman. "Have good internal controls on the business. Have a well thought-through business plan and a good management team."

**'The first generation builds the business, the second generation appreciates what has been built and continues the mission. By the time you get to the third or fourth generation, those shareholders may not value the mission in itself.'**

Keith Lavigne,  
ACE Professional Risk

### FAMILY FEUDS

Potential liabilities can arise from:

- Generational changes
- Nonworking shareholder relatives
- Nonfamily shareholders
- Nepotism
- Ineffective boards



# Webinars help mid-market firms tackle D&O risks, disasters

Executive liability, natural catastrophes and benefit financing issues can bedevil companies of all sizes. But when disaster strikes, middle-market companies can actually find themselves more prone to devastating losses than large, multibillion-dollar firms, which typically are better positioned to absorb the damage.

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## DO YOUR CLIENTS HAVE A D&O PROBLEM?

Increasingly, private/nonprofit companies are looking for ways to shield their top executives from liability and are turning to the same directors and officers liability insurance coverage that large publicly held companies buy.

While shareholder lawsuits drive most lawsuits against publicly held companies, there are other exposures that create a need for D&O protection. Whether they are publicly traded, privately held or a nonprofit, midsize firms face the risk of lawsuits filed by employees, competitors, vendors and regulators. International operations also can create additional exposures.

The webinar focuses on understanding the liability exposures facing midsize companies, and whether D&O protection is the solution. Our expert panel offers advice for middle-market companies as well as the brokers that serve this market. Presenting are Edward M. Joyce, partner, Jones Day; and Bertrand Spunberg, senior vp, management liability product head, Hiscox Ltd.

## ENSURE YOUR CUSTOMERS ARE PREPARED WHEN NATURAL CATASTROPHES STRIKE

With record catastrophe losses in 2011, understanding and managing catastrophe exposures can save lives and dollars, and may make the difference in keeping a business operating through a crisis. This is especially true for mid-market organizations that may not have a dedicated risk manager with the time and resources to be able to focus on such problems and solutions.

This 60-minute webinar reviews not only preparations that organizations can make to minimize damage and business interruption, but also steps to streamline the claims/recovery process after a loss. Our expert panel will focus on advice for middle-market companies, as well as the brokers that serve this market. Presenting are Jill Dalton, partner, Dempsey Partners L.L.C.; and Gregory P. Lan-

she, director of property loss prevention services-risk engineering, Zurich Services Corp.

## EXPLORING ALTERNATIVE RISK FINANCING OPTIONS FOR EMPLOYEE BENEFITS

This presentation covers alternative risk financing options for mid-market companies' health care employee benefit programs, including captives and self-insured arrangements. Attendees will learn about traditional self-funding of health benefits and "blended" programs that combine large deductible plans with a self-

funded health reimbursement arrangement. The presentation also explores using a captive to fund stop-loss coverage for a self-funded benefits program as a way to avoid the risk of "lasering," in which stop-loss carriers laser in on an individual plan member whose health history or diagnosis indicates that he/she likely will be a high-cost claimant. Presenting are Robert J. Melillo, national vp of risk financing solutions, USI Insurance Services; and Rick Stasi, executive vp of alternative risk, Avivent.

—By Matt Dunning



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# Reforms create more liabilities for health groups

*Antitrust litigation poses biggest threat to health networks*

By JOANNE WOJCIK

Directors and officers of hospital and health care systems could face increased liability as a result of forming accountable care organizations authorized under federal health care reform, legal experts warn.

While the possibility of antitrust litigation is perhaps of greatest concern to the directors and officers of hospitals, health care systems and other medical care organizations that integrate to form ACOs, they also may encounter allegations that they violated anti-referral and anti-kickback laws, legal experts note. Potential conflicts of interest could arise if directors and officers serve on hospital and ACO boards simultaneously, they add.

Although ACO regulations issued by the U.S. Department of Health and Human Services provide some safe harbors for ACOs participating in the Medicare Shared Savings Program and the Pioneer ACO Model, there is no guarantee that ACOs operating in the private sector will receive similar protections, legal experts say.

And though directors and officers liability insurance may provide coverage for defense costs and, in some cases, to pay verdicts and settlements that arise from litigation targeting ACOs, it rarely covers civil fines or penalties that may be levied by regulatory bodies, D&O insurance experts note.

Consequently, it is incumbent upon hospital executives responsible for managing the risks associated with forming ACOs to consult their legal and insurance advisers to ensure they are taking appropriate precautionary measures and are adequately covered by insurance should they face litigation or regulatory action, legal and insurance experts advise (see related story).

ACOs, introduced as part of the Patient Protection and Affordable Care Act of 2010, are networks of health care providers that are eligible to receive bonus payments

from Medicare and private payers for improving quality and lowering medical costs through better care coordination.

To achieve the economies of scale necessary to reduce costs and enhance care coordination, hospitals are merging with other health care systems and acquiring physician groups and other types of medical care providers with the ultimate goal of becoming ACOs, according to Cyndy Nayer, president and CEO of the St. Louis-based Center for Health Value Innovation, a leader in the accountable care movement.

So far, 32 leading health care organizations from across the country have been selected to participate in Medicare's Pioneer ACO initiative. Meanwhile, six provider-based entities have received ACO accreditation from the National Committee for Quality Assurance. In addition, several insurers, including Minnetonka, Minn.-based UnitedHealth Group Inc. and Bloomfield, Conn.-based CIGNA Corp., have launched accountable care initiatives that eventually could become ACOs.

But such consolidation and alliances could run afoul of state and federal antitrust laws designed to encourage free-market competition, legal experts warn.

For example, physicians excluded from ACOs, especially in less populated rural areas, may sue if they feel it restricts their ability to attract and retain patients, according to Robert Barberi, Boston-based assistant vp with FINEX North America, Willis Group Holdings P.L.C.'s management liability practice.

"ACOs clearly face antitrust exposure. Those that plan on acquiring a big piece of their market need to be cognizant of this," he said, adding that he saw numerous such claims asserted by physicians when they were excluded from managed care organizations in the 1990s.

Under ACO regulations promulgated by CMS, ACOs that capture greater than a 50% share of a given market must undergo antitrust review, Mr. Barberi said. While the rules also state that market penetrations below 25% will be considered "safe," he said "these rules may change" if regu-

## ACO entities may need own D&O cover

By JOANNE WOJCIK

Directors and officers liability insurance can provide some financial protection from lawsuits against accountable care organizations alleging antitrust law violations, unfair competition and breach of fiduciary duties, insurance experts say.

"The way D&O policies are structured is as an all-risk policy," said Martha Jacobs, senior vp in Aon Risk Services' financial services group based in Pittsburgh. "It is triggered by naming the organization or the directors and officers for wrongful acts in the management of the company."

She said "most carriers still want to apply some sort of coinsurance, retention or sub-limit" for antitrust claims, "although in the last five to 10 years policies have become less restrictive. You'll see more full-limit coverage, not as high of retentions, and coinsurance is being cut back."

But those soft market conditions could change if ACO formations trigger an increase in antitrust allegations, Ms. Jacobs said.

Because each of the organizations participating in an ACO likely will have its own D&O insurance policy, Holly Meidl, national health care practice leader at Marsh Inc. in Nashville, Tenn., expressed concerns about potential conflicts that might arise if an antitrust or other type of claim is filed.

"Everybody's buying independent insurances. My concern is when a case is brought, will it track to the deep pocket? Or is every-

body's D&O going to get tapped? If so, how is that going to play out? Are we going to see the need for a joint defense? Is there a need for a different type of policy to address the risks of the ACO?" Ms. Meidl asked.

There is no specific D&O insurance product designed for ACOs available, but the entities forming ACOs still may need to purchase a separate D&O policy covering all of the participating organizations as added protection, said Mark Karlson, a Hartford, Conn.-based managing director at FINPRO, Marsh Inc.'s financial and professional liability practice.

Ed Wrobel, managing director in Towers Watson & Co.'s risk consulting and software practice in Weatogue, Conn., said adopting such a uniform risk-transfer approach, perhaps using a captive insurance company to insure the D&O risks of the ACO, could lead to more coordinated risk management efforts among the participating organizations, ultimately reducing their antitrust exposures.

To protect their organizations from potentially costly missteps in ACO formations, Ms. Jacobs advises executives responsible for managing the risks of health care organizations to "sit down with underwriters to educate them about the steps being taken to analyze potential antitrust exposures."

"They need to do the correct due diligence, analyze the safe harbors to make sure they're protected by them, and maximize insurance coverage by limiting coinsurance, limiting retentions that apply to these claims as much as possible," she said.

# 50%

Under ACO regulations promulgated by CMS, ACOs that capture greater than a 50% share of a given market must undergo antitrust review.

lators decide competition is being negatively impacted.

Hospitals or health care systems that make acquisitions to achieve clinical integration capabilities also could be charged with violating federal Stark and anti-kickback laws that prohibit physicians from referring patients to facilities in which they have a financial interest, according to Gary Scott Davis, a partner at McDermott Will & Emery L.L.P. in Miami.

The MSSP and Pioneer ACO have "have built-in waivers with respect to some of these laws," he said. "But if you're doing a clinical initiative in the private sector with a commercial insurer, and part of the monies generated are distributed to doctors, you don't have the protection of those waivers."

PPACA "initiated a paradigm shift in terms of how health care is supposed to be delivered, moving away from episodic fee-for-service treatment to more value-based treatment. Those laws were enacted during the prior paradigm. Regulators can't simply throw away all the enforcement activities they've had historically. It creates some potential uncertainties and legal liability exposures for providers until this gets sorted out," Mr. Davis said.

Brian Dunphy, managing director at Frank Crystal & Co. in New York, said nurses unions also could file antitrust suits against ACOs if nurses' roles change, resulting in lower pay in order for their employers to qualify for bonus payments.

"They could argue there is price-fixing on their salaries by the ACO," he said.

ACO formation also places greater fiduciary duties on directors and officers of hospitals and health care organizations, Mr. Davis added.

"As we start to look at shared savings, continuum of care and population health management, if my board has a dual role as serving as both the board of directors of the hospital and the ACO, you've got an inherent and potential conflict of interest for each and every board member," Mr. Davis said. Each board member is "only one person," but he or she "may have two different duties of loyalty and need to know which to apply in what context."

**'ACOs clearly face antitrust exposure. Those that plan on acquiring a big piece of their market need to be cognizant of this.'**

Robert Barberi, FINEX North America

# Reputational harm, EPL among risks facing nonprofits

By **MATT DUNNING**

Though the charitable nature of their endeavors wins points in the court of public opinion, a wide world of financial and legal liability exists for executives and board members of nonprofit organizations.

Recently, accusations of sexual abuse and misconduct against educational and recreational organizations have cast a bright light on the damage an organization's reputation can sustain in the midst of a scandal. In an age when information—whether verified or not—travels instantly and globally, experts say nonprofit leaders are more worried than ever about potentially irreversible reputational harm.

"It's called a flash crisis, where suddenly there's a series of tweets or a blog post, or a rumor catches on, and it develops into a frenzy of negative attention for the organization," said Melanie Lockwood Herman, executive director of the Leesburg, Pa.-based Nonprofit Risk Management Center.

Unfortunately, the totality of reputational harm is largely an uninsurable risk, Ms. Herman said. However, some executive liability insurance programs may include limited coverage for public relations costs in the event of a crisis.

But, she said, "it's not intended to make you whole again."

Recent events notwithstanding, experts say lawsuits and regulatory actions regarding employment practices still constitute the biggest source of legal liability for nonprofit organizations. Just like employees of private and publicly traded companies, nonprofit workers can sue an organization and its individual executives and trustees for discrimination, harassment or wrongful termination based on age, race, religion and gender, as well as disability accommodation and wage-and-hour disputes.

Accordingly, most insurance buyers in the nonprofit market—about 63%, according to a 2012 *Business Insurance* survey—bundle any directors and officers' liability insurance with employment practices liability coverage.

Regardless of the service they provide, directors and officers of nonprofit firms can be sued by donors, beneficiaries or the government for breaching their fiduciary responsibilities, mismanaging collected funds, acting beyond their chartered authority or violating state or federal laws, nonprofit risk experts said.

Nonprofit executives also could find themselves facing client allegations of harassment, discrimination, poor products or poor service; competitor allegations of unfair trade practices; or vendor and supplier allegations of breach of contract.

And, as would be the case at a privately held company, infighting among nonprofit executives and trustees often can lead to a mismanagement or conflict-of-

interest lawsuit.

"I think many nonprofit leaders overlook the potential for claims from other leaders within their own organization," Ms. Herman said. "There's a tendency to think that the biggest risks are external, but the more likely scenario is that the claim is generated by someone on the organization's board of directors, or a member of an association or an employee.

"Inadequate preparation for those kinds of claims is probably the biggest gap in terms of risk management for nonprofits," she added.

Some risks are less universal and are more likely to cause problems in only certain sectors of nonprofit business, experts said. Nonprofit hospitals and health care organizations, for example, face a greater exposure to antitrust claims linked to mergers and acquisitions, physician accreditations or other behaviors viewed as being hostile to competition, particularly to commercial competitors.

"Antitrust activity for nonprofits has really increased in the last few years, as the Department of Justice and the Federal Trade

Commission have become much more active on the enforcement front," said Bertrand Spunberg, senior vp of Hiscox USA's management liability group based in New York. "In particular, both the DOJ and the FTC have been looking very closely at M&A activity in the wake of the Patient Protection and Affordable Care Act, which is driving a lot of that activity."

In the education and social work fields, students or their parents could bring a lawsuit against a private school, university or a specialized learning center if they feel they were not provided with a

quality education or—as could be the case with former Penn State coach Jerry Sandusky and the Second Mile Foundation—failed in their fiduciary duties to protect the well-being of those they serve.

"Directors and officers of charitable organizations will be watching very closely what happens with that case," Mr. Spunberg said. "There's a chance that the leaders of Second Mile could find themselves the target of civil and criminal complaints that they breached their fiduciary duty, which only may be covered by their D&O policy."

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## OVERSEAS RISKS

Sources of claims against directors with international exposures.

- Regulatory actions
- Solvency risks
- Environmental legislation
- Trade embargoes
- Competition law
- Emerging markets

# Company executives exposed to mounting risks overseas

## International regulators becoming more aggressive

By **STUART COLLINS**

U.S. private and nonprofit companies are paying more attention to their growing international directors and officers exposures.

In particular, ongoing financial and economic turmoil is driving claims for regulatory and insolvency risks.

Directors sitting on the board of a U.S. company or a foreign subsidiary, and those working overseas for all or part of the year, are exposed to international regulatory and shareholder actions, said Tom Sheffield, New York-based senior vp at Marsh Inc., the brokerage unit of Marsh & McLennan Cos. Inc.

Directors with private companies that are subject to securities laws—such as through publicly traded debt—and in heavily regulated or politically sensitive sectors are most at risk from international exposures, he said.

Directors of private companies are generally less exposed to securities law than those of public companies, but they are at risk from a range of overseas rules and regulations.

Subsidiaries of all corporate entities, whether private or public, have to comply with local legislation and are at the mercy of local regulators, said Chris Hewitt, London-based partner at Lockton International, a unit of Lockton Cos. L.L.C. For example, the United Kingdom has fairly onerous legislation under the Financial Services

Authority as well as the Companies Act, and more recently under new bribery and corporate manslaughter laws, he said.

With a reduced exposure to shareholder litigation, the biggest overseas concern for private and nonprofit companies is regulatory risks, including corporate governance rules, bribery legislation and competition rules among others, said Mr. Hewitt. “Regulators have more teeth, and the accountability and responsibility of directors is increasing in many countries outside the United States,” he said.

Regulatory risk is the No. 1 D&O concern for most private companies, said Mr. Sheffield. Regulators in many countries have become more aggressive since the financial crisis in 2008, he said. For example, Germany introduced new legislation in 2009 that applies a mandatory personal deductible for individual directors of public companies, although insurers have developed insurance to cover this personal exposure, he said.

“Some of the riskiest countries for U.S. directors are those hit by the financial crisis and that have seen regulators respond with legislation,” said Mr. Sheffield. “Emerging markets also present a problem because directors may be exposed to substantial risk, but local rules and their enforcement can lack clarity and are often not tested,” he said.

Politicians are increasingly developing new regulations and looking to impose existing ones, Shelley Norman, Chicago-based head of private and nonprofit management liability for financial lines in the U.S. and Canada at Chartis Inc., the property/casualty insurance unit of American

International Group Inc. Private companies also see exposure through the variety of legal systems that are constantly changing, she said.

“D&O claims relating to the overseas risks for private companies can arise from legislation in the United States or overseas,” said Ms. Norman. “However, the uncertainty of how legislation is enforced in foreign jurisdictions lends itself to more concern.”

### Regulatory activity up

There has been a general increase in overseas exposure for directors and officers with increasing legislation and cross-border regulatory cooperation, said Ned Kirk, a partner at law firm Clyde & Co. L.L.P. in New York. “We are seeing more regulatory activity around the world, and we are already starting to see an uptick in claims for dealing with the costs of investigations and subsequent litigation for some sectors,” said Mr. Kirk.

“Regulatory investigations are a big concern, and insureds should carefully consider how broad their D&O cover is and what types of regulatory investigation they could face,” said Mr. Kirk. “We are in a period of international regulatory change and uncertainty that makes D&O cover even more valuable for private companies operating overseas,” he said.

Directors’ ultimate fear is that they could end up in prison for violating a foreign government’s rules, said Mr. Sheffield. “But they are also concerned with the costs of being involved in a regulatory investigation, which is often not effectively covered by D&O policies.”

“Some clients are very sensitive to inter-

national exposures, but many others are not up to speed,” said Mr. Sheffield. “But more and more companies are paying attention to international exposures with the Foreign Corrupt Practices Act and focus on offshore tax revenues. It is a growing issue for U.S. companies.”

There also is an increased trend for regulatory actions targeting individual directors and not just corporations, according to Nadia Cote, Paris-based financial lines manager for Continental Europe for ACE Europe, a unit of Zurich-based insurer ACE Ltd. For example, the number of FCPA actions against individual directors of European countries has risen, she said.

The value of D&O policies for the directors of private companies is demonstrated when they are drawn into regulatory investigations, said Mr. Hewitt. For example, Brazilian authorities can jail directors and freeze their assets to stop an accused director of absconding. “D&O can cover the cost of legal representation and will cover the bail bond,” said Hewitt.

The biggest exposure for a director of a private organization in the current economic climate comes from the financial status of a company, said Steve Pearsall, London-based underwriter at New York-based Navigators Group Inc.

“Solvency risks are the biggest driver of claims for private companies,” said Mr. Pearsall. “If a company goes under, creditors may bring an action against the directors, and we have seen an uptick in these types of claims in recent years.”

If a subsidiary of a U.S. company goes into bankruptcy or liquidation, it can result in big liabilities for directors in countries like France and Italy, said Ms. Cote. Directors who are found negligent in France have unlimited liability to pay the debt of a company, while the assets of directors in Italy can be frozen, she said.

“The corporate veil is much thinner outside the United States, and individual directors can be held personally liable for actions that U.S. directors would not typically consider one of their responsibilities, for example, being held liable in a bankruptcy,” said Ann Longmore, New York-based executive vp at Willis North America, a unit of brokerage Willis Group Holdings P.L.C.

“Solvency is a big overseas concern, both in terms of exposure and insurance,” said Ms. Longmore. “In some countries, local policies include an exclusion that effectively makes the policy null and void in the event of insolvency.”

Directors of private companies also are exposed to other regulations to differing degrees, depending on the country, experts say.

For example, environmental legislation is another potential source of claims for directors, in particular with the heightened awareness after the Deepwater Horizon oil spill in 2010, said Mr. Pearsall. “We are seeing claims for directors, such as in Israel, for breaches of environmental legislation, although such claims have so far not been very large.”

Trade embargoes, such as those enforced by the U.S. Treasury Department’s Office of Foreign Assets Control, could be another source of claims against directors, said Mr. Pearsall. The rules also would prevent U.S. insurers from paying claims in countries that are subject to restrictions, such as Iran, he said.

“This is a big issue for U.S. companies, but it has not led to specific D&O claims yet,” he added.

Competition law also is an issue of increasing relevance for the directors of private companies, said Ms. Cote. For example, European competition regulators have stepped up their activities in recent years, and more claims are expected in the future, she said.

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# Executive liability market shows some signs of firming

*Rate reductions ease, price hikes enforced on tougher accounts*

By MATT DUNNING

During the past several months, many expert analyses of conditions in the executive liability insurance market for private and nonprofit companies have included phrases such as “transitional,” “in flux” and “shifting slowly.”

In practical terms, those phrases indicate good news and bad news for insurance buyers in the coming year, experts say.

For many privately held and nonprofit organizations, directors and officers insurance and other companion policies are likely to remain affordable and fairly broad in terms of covered risks in 2012, several D&O brokers said.

However, while new underwriters continue to enter the market with competitive offers, experts say the deep discounts on new premiums and double-digit percentage drops on renewal rates of the last six to seven years are proving unsustainable.

As a result, several “major carriers” already have indicated they will take a stricter approach to placing and renewing D&O coverage for private firms this year, especially small and middle-market firms, experts said.

“In the last six months of 2011, several different insurers in this space made it clear that they were taking a number of what you could call defensive or conservative postures,” said Kevin LaCroix, executive vp at OakBridge Insurance Services L.L.C. in Beach-

wood, Ohio. “We’ve had at least one carrier tell us that they’re trying to move away from private companies with employee counts over 500 because they couldn’t get the pricing levels that their own claim experience was telling them that they needed.”

Smaller private and nonprofit policyholders in most industries and jurisdictions should expect their renewal rates to either remain flat or increase 5% to 7% in 2012, experts said, while larger accounts in lower-risk industries

## 30%

Companies and nonprofit organizations in high-risk industries—such as health care, advanced technology, financial services and retail—could see premium rates jump by as much as 30%.

and jurisdictions might still see single-digit percentage decreases on their renewals. Companies and nonprofit organizations in high-risk industries—such as health care, advanced technology, financial services and retail—could see premium rates jump by as much as 30%, said Philip Norton, national managing director for Itasca, Ill.-based broker Arthur J. Gallagher & Co.’s management liability practice.

“We’re seeing walk-away pricing



## EXECUTIVE RISK GLOSSARY

**DEFENSE COSTS:** Legal fees incurred in the course of defending a company or its executives and board members from a liability claim.

**DIRECTORS AND OFFICERS LIABILITY INSURANCE:** Covers executives and board members of a company or nonprofit organization for lawsuits caused by unintentional wrongdoing, misleading statements, negligent acts or omissions.

**ENDORSEMENT:** A written alteration of an insurance policy’s coverage, terms or conditions. May also be referred to as a rider.

**ERRORS AND OMISSIONS COVERAGE:** Covers businesses such as lawyers, accountants, architects and other professional services entities for negligent acts and omissions that in some way harm a client.

**EMPLOYMENT PRACTICES LIABILITY INSURANCE:** Covers employers against claims of wrongful termination, discrimination, harassment and other violations of workers’ legal rights.

**EXCLUSION:** Language used by insurers to eliminate or limit coverage for certain risks and liabilities.

**FIDELITY/CRIME LIABILITY:** Covers claims against an entity and its executives in which employee fraud or theft has harmed a third party.

**FIDUCIARY LIABILITY:** Covers claims against an entity and its executives alleging a breach of contract or failure to execute managerial duties, often linked to the management of employee health and retirement benefits.

**INDEMNITY:** Provides financial reimbursement for payments made to injured and/or wronged parties.

**INSURED VS. INSURED:** A legal dispute between two parties insured on the same policy. Generally excluded from coverage.

**LIMITS:** The maximum amount of money an insured party can collect under their policy.

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for the first time in 10 years,” Mr. Norton said, referring to insurers refusing to underwrite erstwhile desirable clients due to pricing concerns. “It’s creating pressure on the brokers to seek alternatives and replacement carriers for these clients. And in many cases, the alternatives are also supporting that initial pricing.”

Indications of firming in the

executive liability market have not deterred new underwriters from entering the space, nor have they demonstrably impaired purchasing trends among private and nonprofit buyers, experts said.

Gallagher’s Mr. Norton estimated purchasing among private companies increased by as much as 5% in 2011, when 71% of insurance buyers at private com-

panies indicated they had purchased some form of D&O coverage in 2011, according to a *Business Insurance* survey.

“We’re definitely seeing purchasing patterns picking up,” Mr. Norton said.

The number of insurers offering some form of private/nonprofit

Continued on next page

CONTINUED FROM PREVIOUS PAGE

D&O coverage also grew in 2011—by as much as 22%, brokers estimated—but that growth may owe more to insurers' struggles in other insurance markets and anticipation of more price firming than the prospect of reaching millions of untapped potential clients.

"Some carriers are trying to expand their product offerings because their growth has stalled, and some carriers are thinking the market will firm up in the future and that this is a good time to enter," Mr. Norton said.

On the whole, buying habits among private and nonprofit firms remained largely unchanged from a year ago, experts said. As lawsuits related to employment practices liability, benefits management and employee theft still represent the vast majority of claims against private and nonprofit executive liability programs, about 63% of the D&O coverage sold in 2011 was bundled with EPL, fiduciary and crime/fidelity coverages.

Predictably, the few new developments in the private/nonprofit D&O market in 2011 were informed by the sour state of the nation's economy, experts said.

Diane Gardner, a Chicago-based senior vp at Marsh Inc., said the number of her private and nonprofit clients seeking to cut bottom-line costs by reducing

their coverage limits—a tactic she and her colleagues discourage—has spiked considerably in recent years.

"About 10% of our smaller private and nonprofit clients renewed at a reduced limit this year," Ms. Gardner said, noting that around 6% of the company's clients had reduced their limit in the previous year.

An analysis of the D&O market by New York-based Towers Watson & Co. released in February 2011 indicated that only 1% of private companies reduced their limit in 2010.

"In terms of a percentage, it's not that big an increase, but it hadn't even been a part of the conversation just a few years ago,"

Ms. Gardner said.

The fallout from the Great Recession—specifically, a higher number of mergers, acquisitions and bankruptcy filings—also has triggered increased focus on excess coverage. Ms. Gardner said she observed a 10% increase among her private/nonprofit clients in quotations for Side A excess insurance, and a 5% increase in actual purchasing.

"That's really been driven in the last year or so by the bankruptcy filings," Ms. Gardner said. "I think we're going to see even more of that going forward. We've probably got another 18 to 24 months where we're likely to have a lot of small companies going the bankruptcy route."



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**IN THE MATTER OF THE REHABILITATION OF FRONTIER INSURANCE COMPANY**

SUPREME COURT, ALBANY COUNTY  
INDEX NO. 97/06

**NOTICE OF FILING OF PROPOSED REHABILITATION PLAN**

BENJAMIN M. LAWSKY, the Superintendent of Financial Services of the State of New York, in his capacity as Rehabilitator (the "Rehabilitator") of Frontier Insurance Company ("Frontier") hereby gives you notice that the Supreme Court of the State of New York, County of Albany, has issued an Order to Show Cause dated January 13, 2012, requiring that any interested person or his, her or their attorneys, show cause before the Court at the Albany County Courthouse, 16 Eagle Street, Albany, New York, on the 6th day of April, 2012, at 9:30 in the forenoon of that day, or as soon thereafter as counsel can be heard, why an Order should not be made (i) granting the Verified Petition of the Rehabilitator for an Order approving his Plan of Rehabilitation for Frontier; and (ii) allowing the Rehabilitator such other and further relief as the Court may deem just and proper.

**Please take notice:**

1. That the Order to Show Cause and the papers upon which it is granted are posted on the website maintained by the New York Liquidation Bureau at <http://nylb.org>;
2. That the proposed Plan would authorize the Rehabilitator to continue to settle and pay claims under policies in his sole discretion;
3. That, because of Frontier's limited funds, the proposed Plan would require the Rehabilitator to obtain Court approval as a condition to settlement and payment of any surety or other claim against Frontier;
4. That objections to the Order to Show Cause and relief sought by the Rehabilitator therein shall be served on or before March 16, 2012; and
5. That the Rehabilitator may reply to any objection or other submission by papers served on or before March 30, 2012.

**All objections should be served to the following addresses:**

Frontier Insurance Company in Rehabilitation  
Attn: Al Escobar, Chief Executive Officer  
195 Lake Louise Marie Road  
Rock Hill, New York 12775  
[aescobar@ftrins.com](mailto:aescobar@ftrins.com)

and

William F. Costigan, Esq.  
Dornbush Schaeffer Strongin & Venaglia, LLP  
747 Third Avenue  
New York, New York 10017  
[costigan@dssvlaw.com](mailto:costigan@dssvlaw.com)

Requests for further information or questions should be directed to Frontier Insurance Company in Rehabilitation at (845) 807-5250. Copies of the Order to Show Cause, the Verified Petition on which it was granted and the proposed Plan of Rehabilitation have been posted on the internet site maintained by the New York Liquidation Bureau at <http://nylb.org>.

BENJAMIN M. LAWSKY  
Superintendent of Financial Services  
of the State of New York, as Rehabilitator  
of Frontier Insurance Company

# In the market for D&O? What to know before you buy

Carefully consider individual profile, coverage options

By MATT DUNNING

Thanks in large part to persistently soft conditions in the commercial insurance market, private companies and nonprofit organizations have a wide range of available options for insuring their executives and board members against legal and financial liability.

When it comes to crafting an optimum portfolio for executive liability insurance coverage, some purchases and best practices cut across all sectors of private and nonprofit business, experts said.

However, all insurance policies are not created equal, and the particulars of an effective executive risk management program can vary significantly based on industry, business model and the person ultimately responsible for procuring the coverage.

"There's a perception in the marketplace that executive liability coverage has been commoditized," said Bertrand Spunberg, senior vp of Hiscox USA's management liability group based in New York. "To a certain extent, it's true, but there are some very real and meaningful differences in terms of what is covered and how the policy responds."

Traditional directors and officers insurance coverage is seg-

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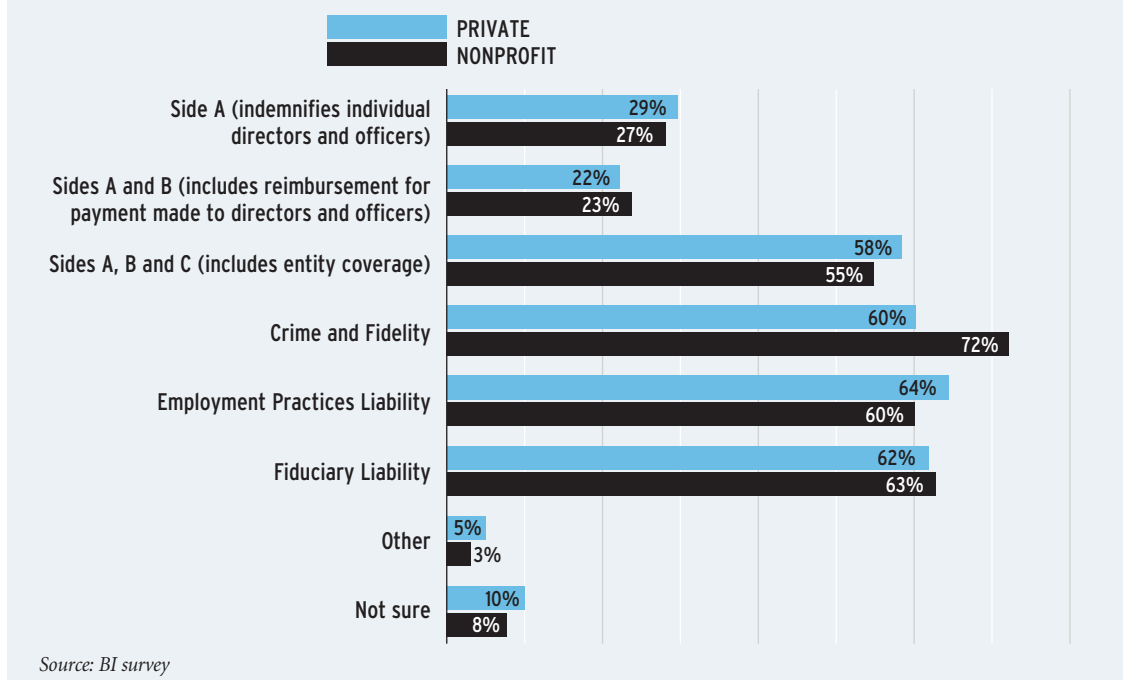
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## WHAT D&O COVERAGE COMPONENTS ARE PURCHASED?

Multiple responses



mented into three categories. Side A provides indemnification for individual officers, Side B includes reimbursement for indemnification payments made to directors and officers, and Side C includes coverage for the entity itself.

While a majority of privately held and nonprofit firms buy all three coverage types—according to a 2012 *Business Insurance* survey—29% of private companies

and 27% of nonprofit organizations indicated they purchase only indemnification of their individual executives and board members.

Because employee allegations of discrimination, harassment or wrongful termination are by far the most frequent sources of executive liability claims for private companies and nonprofit groups, most D&O programs marketed to private and nonprofit firms include employment practices liability insurance.

Claims alleging breach of contract or fiduciary duty and incidents of employee theft or dishonesty also are frequent occurrences for private and nonprofit firms, regardless of size or industry, experts said. Accordingly, more than 60% of privately held and nonprofit insurance buyers add fiduciary and fidelity liability coverage to their executive risk programs, the *Business Insurance* survey indicated.

On top of an executive liability program purchased in the United States, experts said any private or nonprofit firm that regularly conducts business with entities or individuals overseas should carefully consider buying locally admitted coverage as well.

"All of those coverages are things that most private companies and nonprofit groups are going need," said Debbie Schaffel, managing director of the financial services group of Aon Risk Solutions, a unit of Aon Corp., in Chicago. "Clients don't always believe us that they need them, and sometimes it does come down to an assumption that if they haven't had a claim in the past, they won't have one going forward."

Though the construction of executive liability insurance programs can be very similar—if not nearly identical—across most sectors of private and nonprofit business, seemingly minor differences

in policy terms and conditions can dramatically alter the scope of coverage, experts noted.

Where buyers are mostly likely to see those differences manifest is in a policy's response to regulatory action, said Kevin LaCroix, executive vp at OakBridge Insurance Services L.L.C. in Beachwood, Ohio. Mr. LaCroix said insurance buyers for private and nonprofit firms should pay especially close attention to a policy's definition of claim, allocations for defense costs, and allowances made for certain types of punitive actions and investigations.

"There also may be specific provisions for various types of regula-

**'There's a perception  
in the marketplace  
that executive liability  
coverage has been  
commoditized.'**

Bertrand Spunberg, Hiscox USA

tory levees or penalties that a carrier will provide on a limited basis," Mr. LaCroix said. "That tends to be very sector-specific."

To simplify risk management for buyers and boost retentions, underwriters have become more willing to include additional lines of insurance in an executive liability package—or loosen some exclusions and carve-outs—for private and nonprofit firms in certain sectors, experts said.

Depending on its individual risk profile, a privately held or nonprofit professional services company could bundle an errors and omissions policy with its D&O, employment practices, fiduciary and fidelity coverages, experts said. Privately held banks and lending institutions, for example,

typically include a specialized bankers professional liability policy and a lenders liability policy in their executive risk program.

Private and nonprofit health care organizations face a significantly greater amount of regulatory risk than most other sectors, particularly in the form of antitrust claims linked to mergers and acquisitions, physician accreditations or other anti-competitive behaviors—risks that usually are excluded from traditional D&O coverage.

As a result, Mr. LaCroix said, "there's a lot of attention paid to those exclusions. There often are endorsements calculated to address very specific regulatory risks that a health care company might face, particularly if they're in the patient care sector. But even if they're in pharmaceuticals or medical devices, the regulatory risk is a significant thing for them."

An executive risk program's limits on claim payments are every bit as crucial to the success to its effectiveness as the scope of the coverage itself, and every bit as hazardous if improperly managed, experts say. In stressed economic times, some private and nonprofit firms may be tempted to lower their limits in exchange for a discounted premium. But as litigation and defense costs trend upward, experts say insurance buyers should be looking for opportunities to increase their limits, not lower them.

"Organizations change, and litigation trends change. What might have seemed adequate three or four years ago may no longer be up to the task," Mr. LaCroix said. "You at least need to go through the exercise and test your limits on an annual basis, in part because it may cost less to get higher limits than you thought, but also because you may conclude that your profile has changed enough that the higher limits are necessary."

Sharing one policy form among several lines of insurance often means sharing the aggregate limit on payouts, a common practice among small and midsize companies and charities, where buyers tend to prefer lower up-front costs to better respond to potential claims, experts said. However, as Mr. Spunberg noted, using one pot of money to respond to several types of liability is a substantial gamble, as a claim against one particular line can erode the funds available for the rest of the policies.

In most cases, Mr. Spunberg said, the actual cost of defending a lawsuit brought on by an employee, client, consumer, donor or regulatory agency would almost certainly eclipse the difference in price between shared and separate payment limits.

"Options for separate limits are typically more expensive than shared limits by a matter of a few percentage points," Mr. Spunberg said. "It's such that it makes a lot of sense for most buyers to spend a tiny bit more to get much more coverage."



## BUYING LOCAL

Options to consider when insuring your directors and officers risks overseas

- Buy coverage from a global insurer.
- Buy coverage from a U.S. insurer that can arrange overseas cover through a local broker or partner insurer.
- Buy a separate tower of cover for international exposures.
- Buy local D&O policies in each jurisdiction where you have a legal entity.
- Buy a global master insurance policy with sublimits for local jurisdictions.

# Businesses seek new ways to cover overseas exposures

By **STUART COLLINS**

An increasing focus on compliance and coverage for overseas exposures is leading more private and nonprofit companies to consider global programs and local policies, experts say.

A decade ago, most U.S. companies would assume their domestic D&O policies would provide worldwide cover, but they now find there are shortfalls in cover because of local laws, said Tom Sheffield, New York-based senior vp at Marsh Inc., a unit of Marsh & McLennan Cos. Inc. "Increasingly, U.S. companies do not rely solely on their domestic D&O insurers and are seeking new ways to cover their international exposures," he said.

The D&O landscape is changing, with increasing regulation and more claims arising overseas, said Beth Goldberg, New York-based head of middle market for private and nonprofit companies at Zurich North America.

"Private companies are focusing more on their international exposures, and are paying more attention to compliance and insurance coverage. There is more interest in local policies and global programs from private companies than we had seen in the past," she said.

A growing number of private and nonprofit companies are exploring the cover available for their foreign exposures, said Shelley Norman, Chicago-based head of private and nonprofit management liability for financial lines in the U.S. and Canada at Chartis Inc., the property/casualty insurance unit of American International Group Inc. "Interest has increased in finding a structure that provides protection beyond the U.S. global policy for foreign exposures, she said.

"Risk managers and brokers should be careful that they under-

stand overseas exposures and try to find an insurance solution that best matches those risks," said Ms. Norman. "There needs to be much deeper investigation to find a solution that meets the needs of a private company, and that will respond and pay claims when needed."

Marsh is seeking to have more discussion with clients about process, said Mr. Sheffield. "We are spending more time putting the framework in place to identify the global risks and get to the best insurance solution. As regulators focus more on compliance, risk managers need to show that they have acted in good faith and demonstrate they have taken steps on a global basis," he said.

Tax and regulatory compliance has become a hot topic for international insurance arrangements in recent years, with companies growing increasingly concerned that their existing coverage either breaches local rules or will be unable to respond to a claim, experts say.

"International D&O exposures have played second fiddle to U.S. risks in the past," said Brian Botkin, Pittsburgh-based executive vp of executive liability at Chartis Inc. "Past discussion has focused solely on tax compliance, but the fear today is whether the necessary coverage will be provided locally."

### Admitted insurance laws

In several countries, only admitted insurers are able to indemnify directors, experts say.

"More and more countries are moving away from allowing non-admitted insurance and are requiring local policies in a bid to increase tax revenues," said Ms. Goldberg.

In countries like France and Germany, for example, where it is illegal or very complex to indem-

nify directors using the assets of the company, the insurer becomes the only party legally permitted to indemnify a director's legal costs, said Nadia Cote, Paris-based financial lines manager for Continental Europe at Zurich-based insurer ACE Ltd.

"Legal and compliance issues are high on the list of priorities, and clients are demanding greater compliance," said Ms. Cote. "We see a trend toward local policies, with more and more companies buying multinational D&O insurance programs," she said.

If a company and its directors require a great deal of local insurance activity—such as local claims handling and payment—they should consider a local policy, either stand-alone or an underlayer, said Mr. Botkin.

"The fear with a U.S. worldwide policy is that an English-language common-law policy may not sufficiently meet the client's D&O needs in some foreign jurisdictions. A one-size-fits-all policy from a U.S. carrier or Lloyd's is no longer the solution," he said.

The key element for U.S. private companies is the ability of their D&O policy to respond to exposures outside the United States, said Chris Hewitt, London-based partner at Lockton International, a unit of Lockton Cos. L.L.C. "If the insurance is structured in the right way, then local policies will need to be issued where necessary. This is not widely understood by U.S. companies, and there is still a great deal of naiveté around whether they really need local cover."

For example, a company with a local subsidiary in Brazil must purchase a locally sourced policy underwritten by a Brazilian insurer because a policy issued by a U.S. insurer would not be legally recognized.

"Increasingly, companies understand that they have to buy

local insurance policies, although some have been slow off the mark," he said.

Options include buying cover from a global insurer or from a U.S. domestic insurer that uses a broker or partner insurer to arrange local cover where required. Some insureds buy a separate tower of cover for their international exposures or buy local D&O policies in all jurisdictions where they have legal entities, but these are expensive.

There are various ways to structure cover for international D&O risks, although the majority of companies buy a global master policy with sublimits for local jurisdictions, said Mr. Hewitt.

"The same tools are in the tool box for private companies as are for public ones," said Mr. Botkin. "The most common solution is the controlled master (insurance) program, which offers the best of both worlds—a local policy in a local language but with the global protection of the master. This is a growing part of our book of business, as an increasing number of companies opt for their D&O cover under a controlled master program structure."

Chartis Inc., Chubb Corp., XL Group P.L.C., and ACE Ltd. are all offering global programs. But several global insurers—including Allianz S.E.—will not write U.S. D&O as part of a global program.

Domestic D&O coverage with worldwide policy language usually would be sufficient protection for overseas exposures for a private company that does not have operations outside the U.S., said Jennifer O'Neill, New York-based head of international products underwriting North America at Zurich North America. "But even if a company doesn't have overseas entity exposures, it may want to consider local cover if, for example, it has executives that spend a lot of time overseas," she said.

### Alternative options

There are alternatives to a multinational D&O program, said Ann Longmore, New York-based executive vp at Willis North America, a unit of Dublin-based brokerage Willis Group Holdings P.L.C.

If a company is operating only in one or two overseas jurisdictions, it can place its D&O coverage with a U.S. carrier and use a local carrier to write a local policy. Excess insurers will sometimes be prepared to issue a local policy if the primary carrier does not have international capabilities, said Ms. Longmore.

Generally, only companies with overseas legal entities need to buy international D&O coverage, said Ms. Longmore.

Lloyd's is also able to write U.S. and international D&O for private companies.

"Through our Lloyd's platform, we are licensed to write and pay claims in most of the countries we need," said Steve Pearsall, London-based underwriter at New York-based Navigators Group Inc., which underwrites at Lloyd's through Navigators Underwriting Agency Ltd.

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# Perspectives

Policyholders can place themselves in a stronger position to secure their directors and officers liability insurance coverage assets, say Edward M. Joyce, Howard F. Sidman and Lisa M. Cirando of the law firm Jones Day in New York. They can do so by developing a fundamental understanding of insurance and the insurance negotiation and claims processes, and adopting a willingness to fight for the contractual rights they have purchased, the authors say.

## Successful negotiations require insight into claims

By Edward M. Joyce,  
Howard F. Sidman  
and Lisa M. Cirando



Mr. Joyce



Mr. Sidman



Ms. Cirando

There can be no doubt that the past several years have been some of the most economically unstable years in recent memory.

With headlines announcing the collapse or near-collapse of once-venerable financial institutions, manufacturing giants and businesses of all shapes and sizes, Wall Street and Main Street have been affected tremendously.

With such instability, one thing remains constant: Litigation against companies and their directors and officers continues to rise. Such lawsuits potentially are covered under directors and officers insurance, which is purchased by a company to protect against losses due to “any actual or alleged act, error or omission, misstatement, misleading statement, or breach of duty or other duty” by its executives, according to the typical insurance policy provision.

With D&O insurance, the insurer agrees to indemnify, or pay on behalf of, the directors or officers, for a “loss” that those individuals become legally obligated to pay for a “wrongful act” committed in their capacity as a director and/or an officer.

Generally, there are three separate and distinct insuring, or coverage, agreements. The individual directors and officers are protected under Side A. Under Side B D&O coverage, the insurer agrees to reimburse the company for indemnifying its directors and officers. Side C covers liabilities resulting from claims made directly against the company.

In the typical D&O policy, there may be a few paragraphs that set forth the coverage agreements and several pages of exclusions in the preprinted form, with additional exclusions added by endorsement. For this reason, it is often easier to tell what is not covered in a D&O insurance policy

than what is covered.

Some of the most common policy exclusions preclude coverage for illegal profits; fraudulent acts; certain prior acts; “insured vs. insured” claims, increasingly the “entity v. insured” exclusion; outside directorship claims; Employee Retirement Income Security Act claims; and employment claims. These attempts to narrow the scope of coverage increase the likelihood that disputes between the

**There is a danger that the expected seamless protection that the corporate policyholder intended to buy for its directors and officers has holes. Therefore, it is imperative that the company, as well as its directors and officers, understand the coverage afforded by their D&O insurance policies.**

policyholder and insurer may arise when a claim is filed.

Although any holes in coverage created by exclusions may be filled by the purchase of more specialized policies, often the fit of the insurance excluded with the insurance provided by the specialized policy is not exact. There is a danger that the expected seamless protection that the corporate policyholder intended to buy for its directors and officers has holes. Therefore, it is imperative that the company, as well as its directors and officers, understand the coverage afforded by their D&O insurance policies.

A D&O policy provides insurance for liabilities resulting from “wrongful acts” committed by the covered individuals acting in their capacity as directors and officers. More specifically, wrongful acts generally are defined to include “any actual or alleged act, error or omission, misstatement, misleading statement, or breach of duty or other duty” committed by the directors or officers in the discharge of their duties and solely in their capacity as directors and officers.

Frequently, insurers reserve their right to deny coverage on the grounds that the wrongful acts were not committed in the defined “director or officer” capacity. They may argue, for example, that the individual was acting to advance his or her own particular interest, or in the capacity of an employee.

For instance, senior management during a labor strike may perform tasks usually handled by employees; an insurance company likely would argue that any liability arising out of such conduct was not committed in their capacity as directors and officers. Similarly, a suit brought against an officer or director by a customer or client may trigger a denial on the basis that the wrongful act was committed while rendering professional services, rather than in the defined capacity as a director or officer.

Likewise, insurance companies may attempt to limit their exposure by denying coverage based on the illegal profit and fraudulent acts exclusions.

The illegal profit exclusion prohibits coverage of claims that arise from “the gaining by any insured of any personal profit, remuneration or advantage to which they were not legally entitled.” While this ultimately is an issue of fact that must be proven, insurers have argued that the exclusion is intended to apply even without an adverse final judgment in the underlying case. Some insurers add the phrase “in fact” or “final adjudication” to the exclusionary

language to avoid any ambiguity.

The requirement of a final adjudication inures to the policyholder’s benefit because it eliminates an insurer’s ability to argue for the application of the exclusion prior to a final judgment, which has been interpreted to mean any appeal of a lower court decision. In addition, some insurers have argued that the illegal profit exclusion applies when improper profits have been received by the corporation.

Like the illegal profit exclusion, the fraudulent acts exclusion may include “in fact” or “final adjudication” language. The operative language varies. For example, some policies exclude coverage of claims “for any deliberate dishonest, malicious, fraudulent or criminal act or omission, or any willful violation of the law by any insured.” Another policy may exclude claims “arising out of, based upon or attributable to committing in fact of any deliberate criminal or deliberate fraudulent acts by the insured.”

It is important to keep in mind that, depending on the policy language, neither the illegal profit nor the fraudulent acts exclusion may apply if the underlying claim is settled.

Allocation is another frequent source of contention between policyholders and D&O insurance companies. Insurers routinely argue that they are entitled to apportion the costs of the defense and settlement/judgment between insured and uninsured parties or claims in the underlying lawsuit.

For instance, both the company and individual directors and officers usually are alleged to have committed the same wrongful acts, and the claims typically are defended and settled jointly. By attempting to allocate costs between what is covered (e.g., the director or officer) and what is not covered (e.g., the corporation), the insurer may reduce its exposure.

Allocation issues generally occur at two points. First, there is the allocation of defense costs and expenses while a lawsuit is pending. Second, there is the allocation of indemnity payments at the time of a settlement or judgment.

When a D&O policy makes no

Continued on next page

CONTINUED FROM PREVIOUS PAGE

reference to issues of allocation, insurers regularly attempt to allocate the costs of defense and indemnity on what may appear to be an arbitrary basis, especially if an allocation percentage is reached with little or no investigation. It is vitally important that policyholders do not merely accept the insurance company's offer; rather, they should engage the insurer to negotiate a fair allocation.

There are various methods to arrive at a fair allocation. Initially, courts applied what has become known as the "relative exposure" rule, whereby the relative exposure of the various parties—including insured, noninsured and outside consultants—were considered, and the costs were allocated according to each party's exposure.

The types of factors considered by the courts in determining relative exposure have varied widely and include such things as the risks and hazards to which each party was exposed, along with the relative "deep pockets" of the parties.

More recently, courts have refused insurer attempts to limit their exposure through allocation. Utilizing the "larger settlement" rule, courts recognize that the principal wrongdoers often are the insured directors and officers, not the uninsured corporation.

Today, most D&O insurance includes provisions that explicitly set forth an allocation formula, agreed to by the parties in advance. Some policyholders choose to avoid the allocation issue altogether by purchasing "entity" insurance for the corporation, as well as for the officers and directors, at least for frequently asserted claims.

One of the most hotly contested issues in determining the availability of coverage for governmental and regulatory investigations is whether a subpoena or a governmental investigation falls within the definition of a "claim" under a D&O policy.

D&O policies define the term claim in myriad ways, although nearly all associate a claim with civil lawsuits, and some include criminal or administrative proceedings. Some policies also add arbitration and mediation to the list. Other definitions include "a

formal civil, criminal, administrative regulatory proceeding or formal investigation" or explicitly identify investigations "commenced by the service of a subpoena." Other policies use the phrase "a written demand for monetary or nonmonetary relief."

Recent case law demonstrates how important and costly this issue can be to a policyholder. For example, in *MBIA Inc. vs. Federal Insurance Co.*, the policyholder won coverage at appeal before the 2nd U.S. Circuit Court of Appeals for defense costs relating to investigations and costs related to a special litigation committee probe and independent consultant's review. However, in *Office Depot vs. National*

*Union Fire Ins. Co. et al.*, the 11th U.S. Circuit Court of Appeals found no coverage for \$22 million in costs related to an internal investigation and an inquiry by the U.S. Securities and Exchange Commission.

In the wake of the recent economic instability, many policyholders may be tempted to consider obtaining insurance from a different D&O insurer. Policyholders looking to change should be aware that gaps in coverage may result from such a switch. However, policyholders do have the power to minimize any such gaps.

First, policyholders should consider either negotiating with the new insurer to remove the prior

acts exclusion, which precludes coverage of claims occurring prior to a designated "continuity date," or requesting that the new company use the same continuity date as the prior policy.

Second, policyholders with knowledge of circumstances that may give rise to a claim in the future may find it beneficial to give notice of circumstances to the existing insurer to preserve coverage if such a claim should arise in the future.

Alternatively, policyholders may negotiate for coverage of such claims under the new policy.

In a world plagued by an economic crisis and subject to a new set of regulations and rules with uncertain results, lawsuits against

corporate directors and officers are on the rise. Policyholders should take a proactive approach to their potential exposure to these issues and be aware of coverage pitfalls.

*Edward M. Joyce and Howard F. Sidman are partners, and Lisa M. Cirando is of counsel, in the insurance recovery practice at the law firm Jones Day in New York. They can be reached at emjoyce@jonesday.com, hfsidman@jonesday.com and lmcirando@jonesday.com, respectively. This article is not intended to create, and receipt of it does not constitute, an attorney-client relationship. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the firm.*

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ADVERTISER INDEX	
Issue of January 23	
ADVERTISER	PAGE #
Ace Insurance	.....5
Aon Corporation	.....2
Arch Insurance	.....15
Business Insurance	..21, 23, 27, 29, 31
Catlin	.....32
Marcus Evans	.....22
The Navigators Group, Inc.	.....13
OptumRx	.....19
Pilot Catastrophe	.....11
Signature Marketing	.....24
UNICUS Claim Control Inc	.....24
XL Insurance Company	.....17
Zurich North America	.....7

# Perspectives

Employment practices liability is the most frequent type of claim filed against management liability insurance policies for privately held companies and nonprofit organizations, according to a recent *Business Insurance* survey. EPL coverage can help mitigate any negative financial impact such claims can have on middle-market businesses.

## Employment suits can threaten existence of midsize companies

By Ira Holm

**E**mployment practices liability insurance claims for middle-market employers are increasing across the country.

The recent recession has driven up the number of employee lawsuits against their employers for such claims as sexual harassment, age discrimination, disability discrimination, racial discrimination and retaliation—the latter being an up-and-coming growth industry for plaintiffs lawyers who specialize in wage-and-hour and employment practices litigation.

In 2010, 99,992 EPL cases were filed against corporations in the U.S., according to the Equal Employment Opportunity Commission. This is a 7.2% increase in new claims compared with 2009, when 93,277 such cases were filed.

According to the data from LRP Publications, formerly known as the Labor Relations Press, the median award in EPL cases was \$253,000 in 2009. In the same year, there was a 50% chance that an EPL litigation award would fall between \$90,999 and \$979,731.

The most frequent charges filed in discrimination cases are allegations of racial discrimination, which constituted 36% of cases filed, according to EEOC figures from 2009. Gender-based discrimination was alleged in 30% of cases. Age-based claims made up 24%, and allegations from the disabled tallied at 23%.

In many cases, however, multiple allegations are made. One of the increasing charges, according to the EEOC, is retaliation against employ-

ees for making discrimination claims, which can involve a job switch that the employee views as a demotion related to the initial claim.

According to a study by the National Assn. for Mutual Insurance Cos., mid-market companies experienced an increase in EPL charges from 2006 to 2009. Companies with 201 to 500 employees saw a 39% increase in charges, and companies with more than 500 employees saw a 35% increase in charges.

For many middle-market businesses, the concern tends to be litigation arising from layoffs filed on behalf of older, more tenured and higher-paid employees who allege age discrimination.

One of the biggest problems facing the hospitality industry is the rise of wage-and-hour dispute claims by laid-off workers. Laid-off workers can, for example, allege that they were not paid for all hours worked, misclassified or not properly paid overtime.

In the 2011 edition of the Annual Workplace Class Action Litigation Report published by Seyfarth Shaw L.L.P., the 10 most expensive employment discrimination class action settlements in 2010 added up to \$346.6 million, which went up by four times the amount awarded in 2009.

However erroneous the charges may be, lawsuits need to be defended, and litigation costs easily can

drive any business into bankruptcy. For many mid-market corporations that don't have large, in-house legal teams, the nightmare of being dragged into an EPL lawsuit without EPL coverage is not only potentially devastating financially, it also can be stressful and mentally debilitating.

According to national data from Jury Verdict Research, the average cost to defend employment practices

lawsuits for companies that do not have EPL insurance is in excess of \$100,000 for both single-plaintiff and class action suits ranging over \$3 million.

The reality is that for any size corporation, an expense of this size can easily put the company under. The mass layoffs that began with the 2008 financial crisis have brought rise to plaintiffs claiming sex discrimination, age discrimination and racial discrimination. They even see sexual harassment suits being filed months after an employee is laid off for financial reasons.

For companies protected by a simple EPL policy, the insurance carrier usually covers the cost to defend the suit and pays the judgment if one is awarded. Most times, the legal defense costs exceed that of any settlement or judgment, making the purchase of EPL a very smart option.

Fortunately, demand for EPL coverage is rising among employers that acknowledge the importance of having business insurance that will help defend against claims and lawsuits arising from issues of age, race and gender discrimination, as well as wrongful terminations, wage-and-hour disputes, sexual harassment and even sexual misconduct.

However, while employers with 1,000 or more employees are likely to have purchased EPL coverage, only 30.7% of middle-market enterprises buy such insurance protection, according to Middletown, Conn.-based MarketStance, a leading provider of market intelligence to the insurance industry.

Something to consider: The average cost of an employment practices litigation insurance policy is a lot less than paying for even a few hours of legal consultation with a large New York law firm.

*Ira Holm, a former Manhattan restaurant owner, is president of Tarrytown, N.Y.-based RSI Insurance, an insurance broker that has specialized in the restaurant and tavern insurance market for more than 20 years. He can be reached at [ira@rsi-insurance.com](mailto:ira@rsi-insurance.com).*



Mr. Holm

**However erroneous the charges may be, lawsuits need to be defended, and litigation costs easily can drive any business into bankruptcy.**

## News in Brief

### Wal-Mart bias suit in Texas expanded

Plaintiffs in the Wal-Mart Stores Inc. gender discrimination case brought in Texas in October filed an expanded complaint last week to charge widespread discriminatory practices. The filing is the latest in litigation originally brought in 2001 alleging that Wal-Mart promoted and paid female employees less than men, even when female workers had higher performance ratings and more seniority.

### Guernsey, Utah issue new licenses in 2011

Regulators in Guernsey licensed 72 international insurance entities during 2011, up from 47 approved in 2010. At the end of 2011, there were 687 licensed insurance entities in the domicile. Meanwhile, Utah experienced record captive insurance company growth, licensing 69 new captives. The formations brought the number of active captives in Utah to 239 at the end of 2011, up from 188.

### Solvency II proposals may burden captives

Recent proposals for Solvency II may significantly increase the capital and compliance burden for captives, Fitch Ratings Ltd. said. Owners of captives in the European Union likely will have to strengthen their risk management and governance functions and may need to inject capital into their captives to comply with Solvency II's demands. Solvency II will apply to large E.U. captives.

### European Parliament delays Omnibus II vote

The European Parliament's Economic and Monetary Affairs Committee has postponed a vote on amendments to Omnibus II, the directive that will introduce Solvency II in stages, from the end of this month until late March. The committee hearing and vote were slated for late January but now will take place March 21. A European Parliament plenary vote on the directive is slated for April.

### Amazon sued in Zappos hacking

A putative class action lawsuit has been filed in federal court in Louisville, Ky., in connection with a hacking incident that accessed personal information on 24 million customers of Zappos.com, a unit of Amazon.com Inc. The Zappos data stolen included names, account numbers, passwords, email addresses, billing and shipping addresses, phone numbers and the last four digits of credit cards used to make purchases.

### 2011 catastrophe bonds reach \$4.6 billion

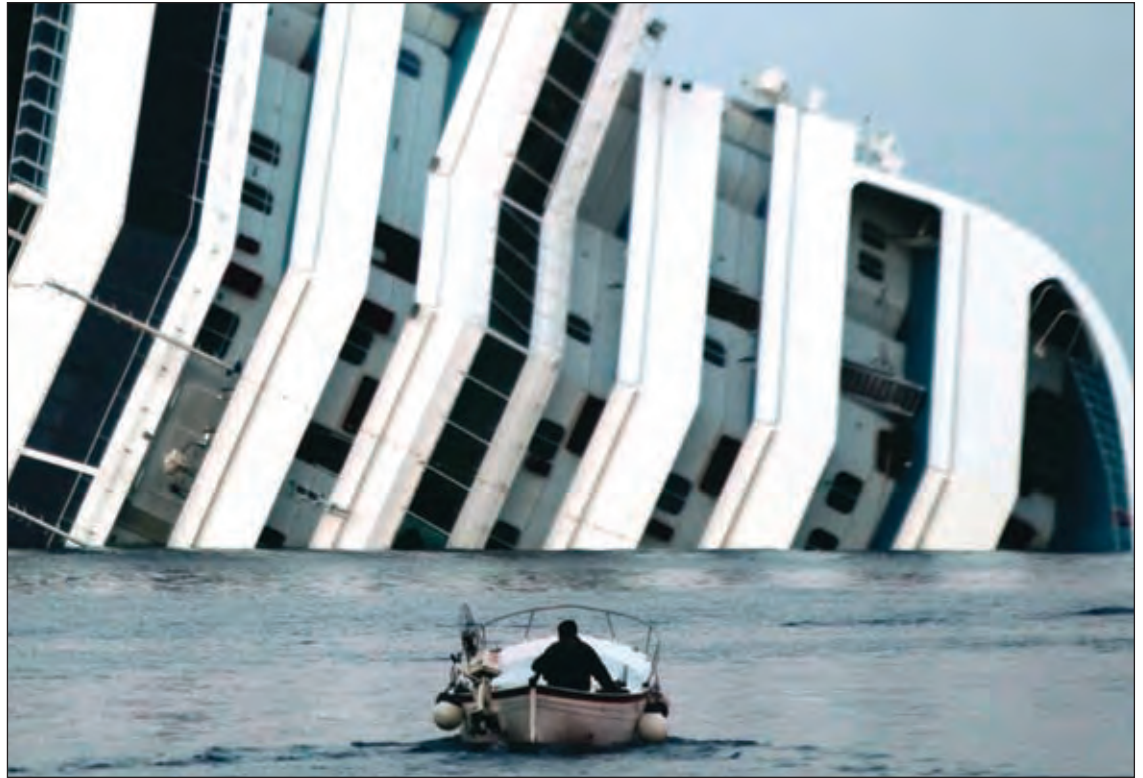
Some \$1.99 billion in new catastrophe bonds were issued during the fourth quarter of 2011 in nine transactions, according to Aon Benfield Securities. Fourth-quarter issuance represented 43% of the year's total activity of more than \$4.6 billion in new insurance-linked securities.

### Survey shows top risk manager worries

Economic risks, business interruption and natural catastrophes top the list of major business risks worrying risk management professionals, according to a survey by Allianz Global Corporate & Specialty of 153 risk consultants worldwide in the second half of 2011. Economic risk was cited as the top concern of 21% of those surveyed, followed by business interruption by 14%, natural catastrophes by 9%, legal and regulatory risks by 7% and reputational risks by 6%.

### Cargo thefts in 2011 increased 8.3%

U.S. cargo thefts increased 8.3% in 2011 to 974, the highest number on record, FreightWatch International (USA) Inc. said. Of 974 thefts, 87.5% involved a complete truckload or container. Among major trends was a continued decline in cargo thefts targeting the electronics sector. These accounted for just 17% of incidents last year compared with 38% in 2006.



AP PHOTO

The Costa Concordia cruise ship lists to one side after running around on rocks near Isola del Giglio, Italy. As of late last week, 11 people were dead and 22 missing of more than 4,200 passengers.

## Cruise ship losses could reach \$1 billion

The Costa Concordia cruise ship accident, which left 11 people dead and 22 missing, could result in insurance claims of up to \$1 billion, analysts said.

The ship, owned by Costa Cruises, a unit of Miami-based Carnival Corp. & P.L.C., ran aground Jan. 13 off the coast of Isola del Giglio, Italy, and turned on its side.

The ship's captain, who reportedly delayed in reporting the mishap and abandoned the ship, has been questioned about the disaster.

Meanwhile, Carnival last week announced a comprehensive review of safety and emergency response procedures for all of its cruise lines.

In a Securities and Exchange Commission filing, Carnival said it has insurance for damage to the vessel

with a deductible of about \$30 million, and third-party personal injury liability subject to an additional deductible of about \$10 million for this incident. Carnival said it is self-insured for the loss of the use of the vessel.

The London-based Standard P&I Club confirmed it is the lead liability insurer for the ship. Assicurazioni Generali S.p.A., Hannover Reinsurance Co., RSA Insurance Group P.L.C. and XL Group P.L.C. are among the ship's insurers, sources said.

In separate research notes, analysts at Espirito Santo bank and Numis Securities Ltd. in London estimated insured losses could range from \$500 million to \$1 billion.

### Religious groups get more time on contraceptive rule

The Obama administration said most religious-affiliated organizations will be given an additional year to comply with a final rule that will require employers to offer full health care coverage for contraceptive services. Health and Human Services Secretary Kathleen Sebelius said religious-affiliated organizations, such as health care systems and universities that do not offer contraceptive services because of religious objections, would have to comply with the proposed rule for health care plan years that start on or after Aug. 1, 2013. For other employers, the requirement, as the administration

proposed last year, would apply for plan years that start on or after Aug. 1, 2012.

### S&P lowers ratings on European insurers

Standard & Poor's Corp. lowered its ratings on several European insurers and some of their subsidiaries, including an Italian unit of Allianz, Mapfre Group and Millenniumbcpc-Ageas Group, each by two notches. It lowered the ratings of Caisse Centrale de Reassurance and Nacional de Reaseguros S.A. by one notch. S&P assigned a negative outlook to the insurers. In addition, S&P lowered its ratings on Societa Cattolica de Assicurazione, Generali Group and Unipol Group by one notch and

kept them on review with negative implications.

### M&As contribute to securities class actions

The number of federal securities fraud class actions increased to 188 in 2011, a 6.8% increase compared with the previous year, with a significant percentage of those stemming from merger and acquisition activity, according to the Stanford Law School's Securities Class Action Clearinghouse in a report. M&A activity accounted for 43 of the 188 filings, or 22.9% of the total, according to the clearinghouse, which prepares its report in cooperation with Boston-based Cornerstone Research.



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## Man says film too true to life

A string of similarities in the 2001 cult-favorite film "Donnie Darko" prompted a California man to file a lawsuit against the film's producers.

Michael Charles Bertsch claims that New York-based News Corp. and subsidiaries recorded his phone conversations and illegally used details from his life in the movie "Donnie Darko."

In the film, after a bizarre accident that nearly kills him, a troubled teenager believes his world will end in 28 days and is guided by a monstrous rabbit named Frank, which only he can see.

According to the lawsuit, which was filed last week in federal court in Washington, Mr. Bertsch lists similarities from the movie that include:

- "The family car in the movie was a sky blue Ford Taurus. My father has the exact same car with the exact same color."

- "Donnie Darko's sister's name is Elizabeth. My sister's name is Elizabeth."

- "In the movie, a black 911 Porsche is parked in front of the Darko house. At the time I owned a black 911 Porsche."

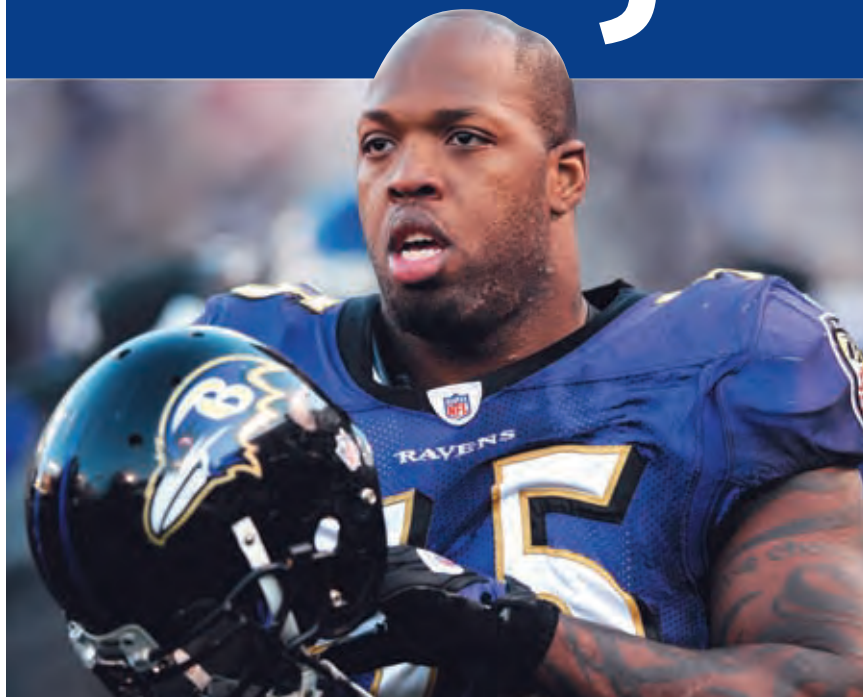
- "Donnie's girlfriend Gretchen is introduced as a new student in the movie. Gretchen is a German name, and my fiancée was living in Germany and resembles the woman in the movie."

- "The main premise of the movie is about a plane engine that drops in Donnie Darko's room. I worked with a company that worked with the FAA in recovering parts and downed aircraft."

According to the complaint, which also names News Corp. Chairman and CEO Rupert Murdoch, Mr. Bertsch says News Corp. is guilty of defamation and invasion of privacy.

CONTRIBUTING: Roberto Cenicerros, Matt Dunning, Judy Greenwald, Mike Tsikoudakis

# End Page



AP PHOTO

Baltimore Ravens linebacker Terrell Suggs caused a stir after he introduced himself on television as "Sizzle," an alumnus of "Ball So Hard University."

## NFL player charges illegal use of brands

What started as a pregame goof has turned into a full-fledged trademark battle for Baltimore Ravens linebacker Terrell Suggs.

During the player introductions segment of the Ravens' nationally televised game against the Pittsburgh Steelers on Nov. 6, Mr. Suggs decided to have a little fun with the standard format of the segment, in which players state their name, position and alma mater. Instead of Arizona State University—where Mr. Suggs actually went to school until he was drafted into the NFL in 2003—the four-time Pro Bowl linebacker identified himself as "Sizzle," an alumnus of "Ball So Hard University."

Three days later, entrepreneur and Baltimore resident Brian Bussells submitted an application to trademark the faux university for a line of T-shirts, hats and other memorabilia. Mr. Bussells already has begun selling the merchandise through his website, BallSoHardU.com. His application included a slightly different design and sample product from the merchandise sold on his website,

which feature a white university logo over purple or black fabric, with a silhouette of a defensive player tackling a quarterback in the center of the design. The design also indicates that the fictional university was established in 1996, the year the Ravens began playing in Baltimore.

However, Mr. Suggs—through his company, Team Sizzle Worldwide—also has been selling merchandise emblazoned with the "Ball So Hard University" tagline for some time, and filed his own trademark application for the phrase 10 days after Mr. Bussells submitted his.

In December, Mr. Bussells received a cease-and-desist letter from Team Sizzle's attorneys, claiming that his clothing line could too easily be confused with the one marketed by Mr. Suggs, and that the merchandise violates the linebacker's right to publicity. However, Mr. Bussells' website remains open, with a disclaimer indicating that the merchandise is in no way endorsed or affiliated with Mr. Suggs or the Ravens organization.

## DEA agent's suit a dud: Court

A federal agent who was shown in a widely distributed video accidentally shooting himself while lecturing children on gun safety lost his lawsuit over release of the video last week.

Lee Paige sued his employer, the Drug Enforcement Administration, after the four-minute video of the 2004 incident in Florida appeared in the news and went viral on the Internet. The video, which is still available online, shows Mr. Paige telling about 50 children and their parents, "I'm the only one in this room professional enough, that I know of, to carry this Glock 40," then proceeding to shoot himself in the leg.

Mr. Paige, a special agent in the DEA's district office in Orlando, Fla., said in the lawsuit that the video invaded his privacy and ended his ability to work undercover or give motivational speeches, and also resulted in humiliating comments toward him and his family on television and in grocery stores and restaurants.

In December 2010, a federal district court judge dismissed the case, holding in part that Mr. Paige had failed to prove the video was retrieved from a system of records and that the disclosure was intentional or willful.

Last week, a three-judge panel of the District of Columbia U.S. Court of Appeals upheld the dismissal. The appellate court said in its ruling that the video contained no "private facts," the accidental discharge of the gun occurred in a public place, "and Paige knew he was being video-recorded."

But the DEA came under criticism for its handling of the case, including the fact that several copies were made of the video, which originally was recorded by one of the parents in attendance.

"The DEA's treatment of the video recording—particularly the creation of so many different versions and copies—undoubtedly increased the likelihood of disclosure and, although not an abuse of a system of records, is far from a model agency treatment of private data."



## Insurance industry execs use their heads for charity

Eight excess and surplus lines insurance industry chief executives shaved their heads in unison last week to raise hundreds of thousands of dollars in donations for childhood cancer research.

The eight "shavees" are part of a St. Baldrick's Foundation team named Expired Coverage.

Monrovia, Calif.-based St. Baldrick's launched after several reinsurance executives took in more than \$100,000 by shaving their heads in 2000 to benefit children with cancer. Since 2000,

nearly 200,000 volunteers have shaved their heads to raise more than \$117 million for life-saving research while also raising awareness about childhood cancer.

Each shavee is like a walking billboard for the cause, according to St. Baldrick's.

This year, the members of Expired Coverage set a goal of raising \$750,000, and as of Tuesday had raised more than \$700,000.

Expired Coverage members include David Bresnahan, president, Lexington



Insurance Co.; Dave Leonard, president, RSUI Group Inc.; Eduardo Lucena, CEO, Colemont Brazil; Frank Murphy, group CEO at THB Group P.L.C.; James Drinkwater, president, AmWINS Brokerage; John Charman, CEO, AXIS Capital Holdings Ltd.; Scott Carmilani,

CEO of Allied World Assurance Co. Holdings A.G.; and Skip Cooper, president of AmWINS Group Inc.

As one might expect, a donor list for Expired Coverage includes many recognizable insurance-related companies and individual donors.

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A photograph of Bill Chambers, a man with a balding head, wearing a white short-sleeved button-down shirt and dark shorts. He is holding a fishing rod with a large reel in his right hand and a white and blue fishing lure in his left hand. He is standing on a boat, with a dark bag and some equipment visible in the background. The background is a bright, hazy outdoor setting, likely a body of water at sunset or sunrise.

Bill Chambers once wrestled  
1,200 pounds of Blue Marlin  
in one day.

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