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The Executive RISKS Issue

Protecting corporate executives from an increasingly complex world of liability exposures

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DIRECTORS & OFFICERS

Corporate mergers create new targets for D&O suits

As restatements fall, plaintiffs take aim at other exposures

By DAVE LENCKUS

Noting soaring numbers of federal shareholder derivative lawsuits over mergers and acquisitions, some executive management liability experts expect plaintiffs to continue moving these cases out of state courts in hopes of larger recoveries.

Others experts anticipate an even broader shift in federal securities fraud class actions. They see financial misrepresentation claims giving way to mismanagement allegations arising from mishaps such as environmental contamination, product defects and industrial accidents.

"I think there's a shift or a couple shifts going on here," said Kenneth W. Ross, executive vp-executive risks at Willis North America in New York.

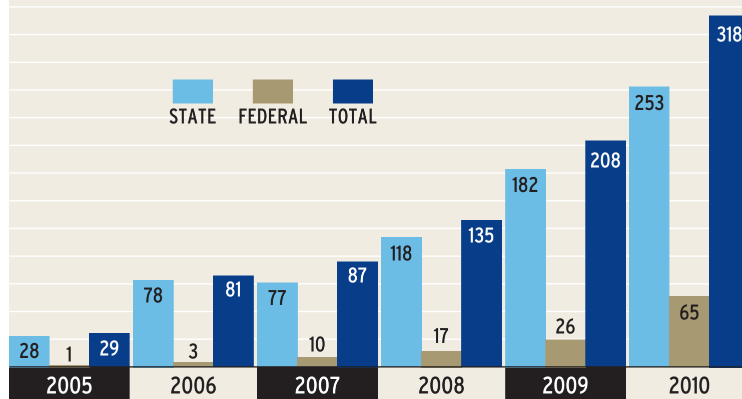
Mr. Ross and other experts point to developments driven by the 2002 Sarbanes-Oxley Act's financial reporting reforms.

Corporate financial restatements are down 59% since 2006, even though they rose slightly in 2010 compared with 2009, reports Audit Analytics, an online research service of Sutton, Mass.-based Ives Group Inc.

As a result, significantly fewer securities fraud cases have been filed, excluding lawsuits over nonrecurring events, according to the Stanford Law School's Securities Class Action Clearinghouse in Palo Alto, Calif., in cooperation with Boston-based Cornerstone Research. In 2010, however, filings jumped almost 69% from 2009's total, largely because of a sixfold increase in M&A-related claims, the researchers said.

M&A SUITS

Number of class actions filed over mergers and acquisitions per year



Source: NERA Economic Consulting

Tenfold jump in M&A suits

In state and federal courts combined, M&A lawsuits have increased more than tenfold since 2005, according to NERA Economic Consulting, a unit of New York-based Marsh & McLennan Cos. Inc. (see chart).

"The sharp increase in federal litigation alleging disclosure violations in M&A transactions suggests that plaintiff lawyers are scrambling for new business as traditional fraud cases seem to be on the decline," Securities Class Action Clearinghouse Director Joseph Grundfest said in a statement.

Meanwhile, the percentage of shareholder fraud class actions alleging product or operational defects nearly tripled since 2006, far outpacing the percentage alleging accounting fraud, according to NERA. The Securities Class Action Clearinghouse said financial misrepresentation cases also declined, but the researchers do not track mismanagement allegations.

How do all the numbers add up?

See **SHIFT** page 18

the EXECUTIVE RISKS issue

The array of risks for company executives and managers continues to grow. Increased financial regulation, international expansion, changing workforce demographics, and pressures to preserve the environment are all adding to the liability burden of executives.

Yet, as companies struggle to operate in a tough economic environment, they are relying more than ever on their key executives to lead the way back to prosperity. What should risk managers do to protect their senior management and allow them to concentrate on their primary business responsibilities?

In this special report on executive risks, *Business Insurance* examines the issues executives face and analyzes the options available to the address the risks.

This in-depth look at a key risk is the first in a series in which we will give over the whole issue of the weekly magazine to one topic. Out next special report will run Sept. 5 and focus on alternative risks.

Meanwhile, to keep up to date on breaking news, visit *www.BusinessInsurance.com*.

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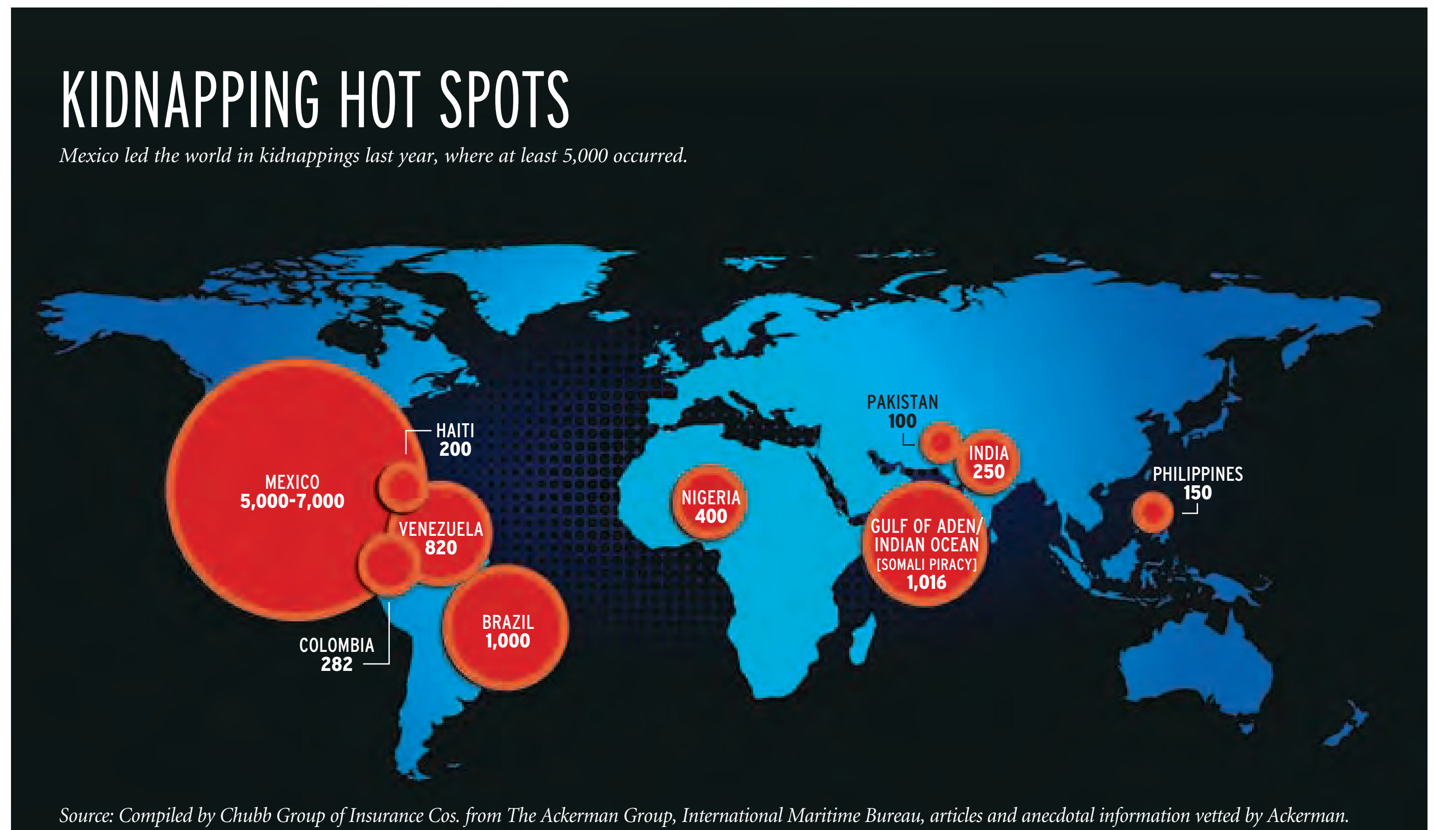
KIDNAP & RANSOM

Employees at risk as firms expand overseas

Kidnapping threats grow in developing economies

By MICHAEL BRADFORD



Source: Compiled by Chubb Group of Insurance Cos. from The Ackerman Group, International Maritime Bureau, articles and anecdotal information vetted by Ackerman.

Companies seeking opportunities in emerging markets face growing threats from kidnappers who see their own prospects improve when new wealth arrives.

Places such as Brazil, India, Mexico and Nigeria are particular hotspots for kidnappings, sources say, as companies expand there to take advantage of developing economies, low operating costs or both.

"As a U.S. company expands to certain areas, it is definitely creating more exposure for itself," said Kevin Guillet, senior vp and fraud advisory practice leader at Marsh Inc. in New York.

Business is booming for kidnappers in some emerging markets, said Gregory Bangs, vp and product manager for crime and kidnap and ransom insurance at Chubb Group of Insurance Cos. in Warren, N.J.

Mexico tops list

In Brazil, there were more than 1,000 kidnappings last year, with many in the Rio de Janeiro and Sao Paulo areas, he said. Mexico, though, "has the worst kidnapping problem in the world" with more than 7,000 in 2010, Mr. Bangs said.

Kidnappings in India have spiked as investment from Western firms has increased, while Nigeria, North Africa and parts of Southeast Asia also have seen notable increases in the crime, sources say.

"In India, the problem is that more and more Western companies are investing there," Mr. Bangs said. While kidnappings in India traditionally involved criminals snatching Indian businessmen, "Westerners are starting to be targeted," he said. "We tell our clients not to assume that that landscape is safe."

"It is a significant problem in many countries, and the problem is increasing," Mr. Bangs said.

In North Africa, for example, kidnapping has become a greater risk as al-Qaida has stepped up kidnapping of foreigners to collect ransoms that can be used to fund the terrorist network, he said.

Experts stress, though, that companies can protect their executives through crisis management and purchasing adequate insurance to cover the kidnap and ransom risk. Surprisingly, many are not doing that, sources say.

"There are a lot of companies that don't have a formal plan in place," Mr. Guillet said. "They may have an ad hoc plan," but not a formalized approach to addressing kidnapping risks, he said.

"Companies need to better understand the nature of kidnap and ransom coverage," said Kit Chaskin, a partner with Chicago policyholder law firm Reed Smith L.L.P. One of the biggest benefits of the coverage is that it provides access to a security consulting firm to help identify the exposure and devise a crisis management plan or respond if there is a kidnapping, she said.

"So much of kidnap, ransom and extortion can be prevented by proper planning," said Richard Hildreth, Reston, Va.-based managing director of Kroll Risk & Compliance Solutions, a unit of Altegrity Inc. in Falls Church, Va.

Companies such as Kroll can do the security legwork for a business before it locates operations in a country with a high kidnapping risk, Mr. Hildreth said. For example, a team can be dispatched to help make the call on where to locate an office.

"We go in and interact with law enforcement, look at the buildings, the access and security controls," which helps the client decide which location is safest, Mr. Hildreth said.

Family considerations

If an office is opening in Brazil, for example, a security consultant will help locate a neighborhood considered safe for the family, where children should go to school, how a spouse should approach working in the country in addition to advising the executive on how he or she should travel to work and what protections should be taken, Mr. Hildreth said.

At some point, a company looking to locate in a high-risk area outside the United States needs to consider whether it's worth

See **KIDNAP** page 21

DIRECTORS & OFFICERS LIABILITY

Why should executives at private firms consider D&O cover?

By MATT DUNNING

For private and nonprofit companies, particularly those in the middle market, the threat of potentially catastrophic litigation against the entity or its leaders can come from virtually anywhere.

Lawsuits brought by employees, customers, business partners, vendors, donors and government regulators can pose serious risks to a private or nonprofit company's balance sheet, as well as the personal finances of its executives and board members. To guard against those risks, a growing number of private and nonprofit firms have been turning to directors and officers liability policies, experts say.

"It's a perfect insurance opportunity in the sense that there are just enough claims to produce the tension, but not so many claims that it's no longer profitable for the insurance carriers," said Philip Norton, national managing director for Itasca, Ill.-based broker Arthur J. Gallagher & Co.'s management liability practice.

D&O was once considered specialty coverage for all but large publicly traded companies. But Mr. Norton estimates that the takeup of D&O coverage among private and nonprofit companies with less than $1 billion in assets has grown an average of 3% to 5% a year since 2000, when the Enron Corp. and WorldCom Inc. scandals cast a bright light on potential exposures for firms of all sizes, even those without obligations to public shareholders.

"There was definitely a rush after that," Mr. Norton said. "It's funny, because here we are with a wealth of information that says these risks have always existed, but because only 1% of your class gets sued each year, it's not surprising that you didn't get hit."

> **'These (D&O insurance) policies tend to be very generous in terms of the things they defend against.'**
> Tony Galban, Chubb Group of Insurance Cos.

Bundled coverage typical

The nature of those risks and the claims they produce typically drive middle-market private and nonprofit companies to bundle D&O coverage with polices addressing other risks, including employment practices, crime and fiduciary liabilities, several market executives say.

For smaller companies, infighting among executives, board members or relatives in a family-owned firm can lead to a mismanagement or conflict-of-interest lawsuit that triggers a D&O claim. Private firms could find themselves facing customer accusations of harassment, discrimination, poor products or poor service; accusations by competitors alleging unfair trade practices; or vendors and suppliers alleging breach of contract.

Nonprofits, meanwhile, could be sued by their donors, government regulators or beneficiaries for misappropriation of funds, acting beyond their chartered authority, violation of state or federal laws, and breach of fiduciary duty (see box, page 20).

"These (D&O insurance) policies tend to be very generous in terms of the things they defend against," said Tony Galban, a senior vp at Warren, N.J.-based Chubb Group of Insurance Cos. Private firms with minority shareholders also can be liable for the same set of securities-related risks as large, publicly traded companies. But without

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A MINOR RENOVATION TO THE FACTORY AVOIDED A MAJOR OPERATION ON THE EMPLOYEE.

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DIRECTORS & OFFICERS LIABILITY

Whistle-blower rewards add to corporate woes

Large incentives make investigations more likely

By MARK A. HOFMANN

WASHINGTON—A provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act that gives financial incentives to corporate whistle-blowers could result in headaches for corporate directors and officers.

Under the provision, a whistle-blower who provides to the Securities and Exchange Commission "original information" that results in a sanction of at least $1 million could receive 10% to 30% of the monetary sanction.

The SEC adopted a rule implementing the provision late last month. Under the rule, which goes into effect Aug. 12, whistle-blowers are not required to go through internal corporation reporting channels before approaching the SEC (see box, page 20). Some organizations, such as the Washington-based National Assn. of Corporate Directors, argued that whistle-blowers should be required to go through internal channels first.

Industry observers are divided over how great an immediate impact the provision will have on corporate directors and officers, although there's general agreement it will lead to increased federal investigations.

"We believe that the biggest impact will be on the volume of SEC investigations as opposed to actions," said Robert Yellen, chief underwriting officer of executive liability at American International Group Inc.'s Chartis Inc. unit in New York.

"It remains to be seen what the impact would be as to SEC actions," said Mr. Yellen "The SEC is fighting for a big increase in its staffing and budget to handle the tips. Until they get that funding, companies may have to shoulder a bigger burden investigating weaker tips so the SEC can preserve its resources for juicier tips."

> 'We believe that the biggest impact will be on the volume of SEC investigations as opposed to actions.'
>
> Robert Yellen, Chartis Inc.

"It will certainly give rise to a number of reports to the SEC," said Kevin LaCroix, executive vp at OakBridge Insurance Services L.L.C., a division of R-T Specialty L.L.C. in Beachwood, Ohio. "The SEC is going to have to come up with its own mechanism for assessing and winnowing which ones they will pursue."

"If nothing else, it means there is a greater possibility that (directors and officers) or their companies" will be pulled into SEC investigations, said Mr. LaCroix. That could lead to more litigation, including shareholder suits, he said. "It creates the prospect of a heightened claim activity environment."

"I would be surprised if it gave rise to a flood" of additional SEC actions, said Tony Galban, senior vp and underwriting manager for D&O insurance with Chubb Group of Insurance Cos. in Warren, N.J. "That would require the SEC to have a ton of staff and it would also require that the complaints made to them be of a consistently high caliber."

Aside from the increased liability and administrative issues, the biggest potential headache could be the controversial executive compensation clawback provision (see related story).

In the meantime, risk managers need to have the right D&O coverage in place as well as a trusted internal process for reporting potential misdeeds, observers say.

"I am continually surprised at how misinformed a lot of insureds are regarding what coverage they do and do not have under their policies today for SEC investigations," said Dan A. Bailey, member of Bailey Cavalieri L.L.C. in Columbus, Ohio. "That's one of the most frequent issues that arise in coverage disputes in a lot of SEC claims today."

Risk managers should review existing coverage and make sure it works in the context of investigations, said Chartis' Mr. Yellen.

He said traditional D&O policies cover claims, but an investigation is not a claim, "so it's important that their coverage does work in this context." Mr. Yellen said Chartis introduced a D&O liability policy this year that offers companies coverage for expenses related to investigations by enforcement authorities such as the SEC.

Although "insurance is only one component of a risk management program," said Mr. LaCroix, risk managers should make sure that insurance is appropriate in terms of quantity and structure. He said companies should consult with lawyers and other professional advisers to make sure they have internal controls to address potential problems.

"If the bounty stands, and it looks like it very much will stand, there will be more attention on whistle-blowers," said Ann Longmore, executive vp of Willis North America in New York. "I don't think we can overemphasize the value of a robust internal reporting system."

"Probably the most important thing is evaluating how effective their internal reporting processes are," said Tripp Sheehan, U.S. D&O practice leader for Marsh Inc. in Boston. This includes looking at the internal reporting system's track record to

See **WHISTLE** page 20

With great sorrow, all of us at SNR Denton bid farewell to our partner, colleague, mentor and friend.

Gary Hernandez
1959 – 2011

We will remember him always for his warmth, kindness, passion and deep commitment to public service.

SNR DENTON

Dodd-Frank pay provisions raise liability questions

By MARK A. HOFMANN

The whistle-blower bounty provision isn't the only potential problem for corporate directors and officers contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, observers say.

Some provisions of the law directly affect liability and others add to administrative burdens, they say. Other than the whistle-blower provision, the biggest potential headache could be the Dodd-Frank Act's controversial executive compensation clawback provision, they say.

The clawback provision requires companies to disclose their policies on incentive-based compensation. Companies also must establish a policy to recover—or "claw back"—incentive-based compensation paid to current or former executives that is more than the compensation that would have been paid "during the three-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data," according to the law.

Tripp Sheehan, Boston-based U.S. D&O practice leader at Marsh Inc., noted the provision strengthens that already contained in the Sarbanes-Oxley Act, which held that incentive compensation of CEOs and chief financial officers could be recouped within 12 months after an accounting misstatement where misconduct was involved.

Under Dodd-Frank, sanctions apply to an expanded pool of current and former executives, do not require misconduct and can be enforced by private actions, he said.

The provision raises interesting questions about what constitutes a loss, said Tony Galban, senior vp and underwriting manager for D&O

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Business Insurance OPINIONS

Wall Street reform law has far-reaching effect

A FEDERAL LAW WITH intended consequences sometimes can give rise to the universal law of unintended consequences.

The Dodd-Frank Wall Street Reform and Consumer Protection Act is a case in point. The intent of the law is pretty straightforward: It's designed to prevent an economic crisis, like the one that exploded in 2008, from occurring again. To do so, it attempts to address what appears to be just about every major aspect of financial activity.

Just ask property/casualty insurers. They're fighting efforts that might define some of them as presenting systemic risks to the economy as a whole. That, in turn, would subject them to heightened and costly regulation.

As we report on page 6, addressing as many problems as possible that might arise from financial activities means drafting provisions that can directly affect nonfinancial services companies and their risk managers as well.

Perhaps the most potentially serious of these is the "whistle-blower" provision. This section of Dodd-Frank provides very attractive financial incentives for employees whose reports of employer improprieties lead to Securities and Exchange Commission sanctions of more than $1 million. In some cases, the whistle-blower could receive a bounty of up to 30% of the sanction.

> *Given the complexity of Dodd-Frank, more problems are certain to arise as rules are promulgated to implement the law.*

Because the provision does not require that the whistle-blower first report the problem to the company's internal compliance reporting system, one can be sure that the prospect of a hefty reward will lead some to ignore any internal program completely and head straight to the SEC.

That said, one of the best things that companies can do to reduce their exposure is to make sure they have an internal compliance reporting procedure in place that employees trust as being fair and thorough. Employees have to know that a system is there and are comfortable with it.

A trusted reporting system alone isn't enough, however. Risk managers have to make sure that directors and officers liability insurance they procure is applicable to cover costs associated with SEC investigations and adequate to cover any exposures.

The whistle-blower provision, while probably the most troublesome for many companies, is not the only problem in the law. Take the "claw-back" provision, which requires companies to craft a policy to recover incentive-based compensation paid to current or former executives that is more than what would have been paid "during the three-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data," as the law puts it.

That raises the question: When does the clawback occur? At the beginning of an action? After a final adjudication? At some other point in the proceedings?

Given the complexity of Dodd-Frank, more problems are certain to arise as rules are promulgated to implement the law. The only certainty about implementation appears to be that implementation will give rise to more uncertainty. The uncertainties may not have been intended or anticipated by the law's drafters, but it will be up to risk managers to be prepared to deal with them in a way that minimizes harm to their employers.

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Q Should the 11th U.S. Circuit Court of Appeals uphold the health care reform law?

NEXT WEEK'S QUESTION

Q: Will the Dodd-Frank reform law significantly decrease the risk of another crisis?

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Business Insurance PERSPECTIVE

Anti-bribery compliance key

By Ann Longmore

In recent years, the Securities and Exchange Commission, the Department of Justice and other regulatory bodies have increased their focus on identifying violations under the U.S. Foreign Corrupt Practices Act, which prohibits U.S. firms from bribing officials to win or maintain business.

While the United States steps up its enforcement, new and broader legislation, such as the U.K. Bribery Act that goes into effect in July, combined with the Organization for Economic Cooperation & Development's Anti-Bribery Convention, means the fight against corporate corruption is going global.

Although the FCPA has been with us since 1977, the size of recent settlements and the global nature of the mix are staggering.

A quick check of the largest settlements—led by Siemens A.G.'s $800 million settlement in 2008, along with several others that cost companies hundreds of millions of dollars—serves as a serious wake-up call for organizations, many of which need to do more to establish a robust corporate compliance environment. While it might be assumed that an organization must have non-U.S. operations to be subject to the FCPA, the rule extends to vendor relationships and joint ventures. So even if a company never leaves U.S. soil, it may well fall under the FCPA's sanctions if others do so on its behalf. Organizations that are complacent about fraud or commit violations face serious exposures.

The direct cost of an FCPA action can include fines and disgorgements for FCPA offenses based on the "benefit received" from a bribe plus penalties, which can amount to hundreds of millions of dollars.

A recent study by Ernest & Young L.L.P., which reviewed 118 FCPA cases involving 242 companies, including subsidiaries, and 167 prosecutions, found that the most likely outcome of prosecutions are civil penalties, followed by criminal fines and plea agreements. When looking at investigations, E&Y found only 3% of all investigations resulted in no action being taken.

It also is important to consider that investigation and legal costs for organizations involved in FCPA investigations can themselves be in the tens, if not hundreds, of millions of dollars, and that's just for direct enforcement. One public company announced this year that it had spent more than $150 million during the past two years in FCPA investigation costs.

Today, one also should expect litigation from stakeholders, including the ever-popular securities litigation and derivative suits, some filed after the mere announcement of an FCPA investigation.

We should not forget the possibility of a jail sentence for an individual resulting from a criminal prosecution. In fact, when looking outside the United States, OECD countries are more likely to charge individuals than entities, with enforcement data indicating that 199 individuals and 91 entities were sanctioned under criminal proceedings for foreign bribery through 2010.

In addition to what may be incalculable reputational costs, ancillary costs in FCPA actions can include drops in stock price and potentially the firm's credit rating, which would drive up the cost of credit; loss of business, especially from public entities; turnover in senior management after a loss of confidence; and merger and acquisition fallout as joint venture partners and possible merger candidates shy away.

The best defense

The best defense is risk mitigation. Now is the perfect time—with the new SEC rules on enforcing the Dodd-Frank Wall Street Reform and Consumer Protection Act's new whistle-blower provisions and the final language of the U.K. Bribery Act in hand—to review and upgrade the firm's internal and external anti-bribery policies and procedures.

Doing so in conjunction with a legal audit of the effectiveness of the company's procedures may be the best way to assess any weaknesses and design a risk-based approach going forward.

A robust, risk-related anti-bribery policy for employees, vendors and business partners likely includes reporting provisions, standards for monitoring and certification controls, as well as a critical education component. In focusing these efforts, some global firms use Transparency International's Corruption Perceptions Index as a guide to potential geographical hotspots around the world. Companies setting leadership standards for global compliance often become a party to the World Economic Forum's Partnering Against Corruption Initiative.

The most likely insurance to respond to FCPA claims is directors and officers liability insurance. Potential coverage under a D&O policy might be divided into two stages: investigation and settlement.

One should expect that insurers are unlikely to view FCPA investigations involving just the company as sufficient to trigger coverage under most policies. The reason is that the typical D&O policy may define its claims trigger as an actual allegation of wrongful conduct and not an investigation into whether wrongful conduct has occurred.

Ms. Longmore

This can be devastating in terms of obtaining insurance coverage for costs of an investigation where the company is the sole target, and no follow-on civil litigation—a securities class action or derivative suit—has been brought. Today, we also consider whether any individual may also be in the scopes of the enforcement agencies.

The universal nature of this position on corporate investigations, generally and specifically as to the FCPA, has led one insurer to develop a separate policy that simply covers the organization for investigations, potentially including FCPA inquiries via an extension; note, though, that fairly low limits of coverage are available for corporate investigations, but this may be changing.

Looking to the second stage, settlements or court awards, generally speaking, fines and penalties typically won't be covered because they fall outside the scope of the policy's definition of loss. While the analysis for the individual is similar but not the same as that for the company, there is a generally available exception to the lack of coverage for fines and penalties for a very specific penalty assessable against individuals for inadvertent violations of the FCPA, which may be covered; the modern twist to this is to add coverage for similar penalties under non-U.S. corruption laws. There also may be broader potential coverage for civil fines under certain Side A D&O programs (covering only nonindemnifiable claims).

Coverage of defense costs also is likely to be broader for the individual defendant at the investigation and litigation stages, though investigative costs may be subject to a fairly low sublimit.

And no discussion of possible D&O coverage for bribery-related charges would be complete without mention of the expected fraud and dishonesty exclusion found in most D&O insurance contracts, sometimes referred to a conduct exclusion or intentional wrongful acts exclusion. While this is likely to apply only where there has been a final adjudication of illegal conduct or intentional illegal conduct, today we are seeing cases go to judgment and individuals adjudicated as guilty.

Ann Longmore is an executive vp for Willis North America in New York, a unit of Willis Group Holdings P.L.C. She can be reached at ann.longmore@willis.com.

FOREIGN CORRUPT PRACTICES ACT

The FCPA, which was passed in 1977 and amended in 1998, prohibits U.S. companies, public and private; U.S. citizens; permanent residents; and certain non-U.S. individuals and entities from bribing foreign governmental officials to obtain or retain business. It has two main components:

ANTI-BRIBERY PROVISIONS

- Forbids offering or giving monetary bribes or "anything of value" to foreign government officials to secure unfair business advantages.

ACCOUNTING PROVISIONS

- Requires companies whose securities or debt is traded on U.S. exchanges to maintain adequate books, records and controls over financial transactions. The Department of Justice and the Securities and Exchange Commission are charged with enforcing the anti-bribery provisions.

Source: Willis North America

Business Insurance
PERSPECTIVE

Global D&O protection tips

By Carol A.N. Zacharias

Buyers of global directors and officers liability insurance have heard the call to buy local policies in countries that prohibit nonadmitted insurance to ensure their local subsidiary boards are protected.

Countries around the world, from Brazil to Japan, have restrictive insurance laws as well as prohibitive tax laws that mandate increasing caution. As a result, buyers are reaching out to insurers, brokers—and even using software on legal issues—to guide them through a virtual phalanx of local laws, rules and regulations.

It is one thing to know that a local policy is required, and it is another to find an insurer that can deliver policies around the world. It is still another to know what the local policy terms and conditions actually provide.

To date, the industry has been focused on the former—where local policies must be bought and what insurer has the global expertise and presence to issue the policies. The focus has not yet been on the latter, yet local policy terms and conditions can be critical to the multinational policy buyer.

Fortunately, a study of D&O policies in countries around the world provides a modicum of solace. In numerous respects, policy terms abroad often are broader than those found in the United States. A less litigious environment; the absence of jury trials, punitive damages and loser-pays rules; the infrequency of or inability to bring class action suits; and restrictions on the ability to bring and maintain actions are just some of the reasons policies outside the United States may offer broader terms.

Whatever the reason, insurance buyers would do well to understand that terms and conditions abroad may be broader. Depending on the country and policy, the following 10 items should be considered:

1. LIMITS AND RETENTIONS: Nonexecutive directors have an additional excess limit of liability in the traditional policy, which applies to nonindemnifiable losses where the policy, or any other D&O policy, entirely or partially covers the claim but those limits are exhausted.

2. INSURED PERSONS COVERED: U.S. D&O policies typically cover duly elected or appointed directors and officers; the entity, but solely for security claims; and employees, if and to the extent that they are co-defendants with directors and officers in securities claims. Local policies go further, however, by also providing coverage for de facto directors, shadow directors, managers and supervisors and, solely for employment claims, all employees.

3. EXTRADITION COVERAGE: U.S. D&O policies may or may not provide coverage for extradition proceedings. Local policies often provide the coverage, and even provide a limit or sublimit to pay expenses of a public relations firm or a consultant engaged to mitigate the adverse effects that may arise from extradition proceedings.

4. INVESTIGATIONS COVERAGE: Under some local policies, coverage for an investigation is triggered if it is an official inquiry, and the attendance at the inquiry of an insured person is required for the first time during the policy period. Some local policies restrict coverage for an investigation brought in the United States to those in which an insured person is subject to a subpoena or indictment, which is consistent with investigation triggers under many U.S. D&O policies.

5. INSURED VS. INSURED COVERAGE: U.S. D&O policies usually exclude suits filed by insureds against insureds in an effort to prevent coverage of collusive litigation. Instead, the policies provide coverage for suits by third parties. In contrast, D&O policies outside the U.S. may have no exclusion or a very limited form of the exclusion. The exclusion may not apply to suits filed by other insured persons. It also may not apply to suits by the entity, if an attorney advises that the entity probably will win the case. Presumably this is to ensure that the entity does not waste corporate assets on litigation that may not result in a positive outcome.

In that instance, it may additionally apply only to claims brought in the United States, and it may not apply to defense costs in any event.

6. POLLUTION COVERAGE: U.S. D&O policies typically exclude claims arising from pollution, subject to some exceptions. In contrast, policies issued outside the U.S. may provide a pollution sublimit for defense costs, shareholder suits and nonindemnifiable losses.

7. CORPORATE MANSLAUGHTER COVERAGE: Various countries permit prosecution of a company and its executives or employees for involuntary manslaughter that occurs in the conduct of the company's business. Local policies issued outside the U.S. cover defense costs and do not apply the bodily injury exclusion to the claim of manslaughter.

8. NOTICE FLEXIBILITY: Local policies in certain regions may provide some flexibility regarding claims reporting, even though the forms are claims-made and -reported, as in the United States. Notice may be permitted after an earlier policy period has ended so long as there is continuity of coverage with the same insurer from policy period to policy period.

Ms. Zacharias

9. EXTENDED DISCOVERY: While U.S. and local policies typically require claims to be reported during the policy period, or within an optional extended reporting period, some local policies provide more. Local policies may provide an additional free 45-day discovery period and an exceptionally long extended reporting period, such as five years. In addition, in the event of a merger or acquisition, the policies may provide that the insurer may offer a runoff period of five years.

10. RETIRED DIRECTORS AND OFFICERS: If a local D&O policy is not renewed or replaced, the policy may provide extended coverage for retired executives for claims made up to six or 10 years, depending on the country, after the nonrenewal.

To the extent that disparate local polices are narrower than the parent company's home country policy, insurance buyers can access underwriting tools to create a seamless multinational program. For example, an endorsement can be placed on the parent company's D&O policy to address those differences. These and other steps should be considered by insurance buyers, at the time of underwriting, to create truly worldwide D&O protection for the multinational insured.

Carol A.N. Zacharias is senior vp and deputy general counsel of North America at ACE Group in New York. She is vice chairman of the professional, officers' and directors liability law committee of ACE's tort and insurance practice section. She also is former co-chair of the insurance subcommittee of the Business Law Section of the American Bar Assn. and is a member of the American Corporate Counsel Assn. She can be reached at carol.zacharias@acegroup.com.

It is one thing to know that a local policy is required, and it is another to find an insurer that can deliver policies around the world. It is still another to know what the local policy terms and conditions actually provide.

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DIRECTORS & OFFICERS LIABILITY

Coverage emerges to pay probe costs of execs, firms

Insurers eye ways to fill key gaps in D&O policies

By MIKE TSIKOUDAKIS

Directors and officers liability insurance has evolved to include expenses related to investigations by regulatory authorities covering directors and officers individually as well as the entity under separate cover.

While most insurers offer preclaim inquiry investigation coverage—also known as coverage of informal investigations—as part of their D&O policies, buyers interested in coverage of corporate entities for costs incurred by U.S. Securities and Exchange Commission and other regulatory investigations have limited options, experts say.

Chartis Inc. is the only insurer to offer such coverage under a separate policy, called Investigation Edge, though other insurers have developed similar coverage on an ad hoc basis, observers say.

Interest in entity coverage as part of a D&O policy is increasing among buyers as SEC enforcement actions have increased, experts say. Since, 2004, there have been more than 3,900 enforcement actions, according to the SEC (see chart).

According to a January study by Stanford Law School's Securities Class Action Clearinghouse and Cornerstone Research, 176 federal securities class actions were filed against publicly traded companies in 2010, a 4.7% increase from 2009.

The standard D&O public company policy form protects individual corporate directors and officers and is triggered when someone is targeted formally by the SEC. It offers coverage for the entity and individuals for securities claims and provides investigation costs only for individuals.

In May 2010, Chartis released Executive Edge, a policy that offers preclaim inquiry notice protection, which covers company executives and board members who are required to respond to an informal investigation and must hire defense counsel and need other services—even if they have not yet been identified as a target in a formal investigation.

"This isn't a small thing," said broker and attorney Kevin M. LaCroix, executive vp at OakBridge Insurance Services L.L.C. in Beachwood, Ohio. "I have certainly seen circumstances in my career, particularly where the corporation has gone bankrupt and there is no entity standing there to provide defense counsel indemnification for the individual, yet they've been requested by the SEC to appear for an interview or to produce documents."

Absent the preclaim inquiry language, the only alternative for an individual director or officer is paying informal SEC investigation-related costs out of their pocket, Mr. LaCroix said.

"It's real protection for the individuals prior to the investigation becoming formal and prior to the individual being identified as a possible target," Mr. LaCroix said.

Other insurers have responded to Chartis' offering with their own versions of preclaim inquiry coverage, and those innovations are available in the marketplace without additional premiums, experts say.

"It's a really great evolution of D&O insurance and really gets back to the root of D&O insurance: to protect the individuals in a difficult and challenging area," said Steve Shappell, managing director of Aon Corp.'s global legal and claims practice in Denver.

But standard D&O insurance still has a gap as it relates to the entity, though buyers may think that costs incurred by the organization as a result of SEC investigations are covered, Mr. Shappell said.

Those costs—for retaining counsel and retrieving, viewing and preparing documents to provide the SEC—could be quite substantial, observers say.

For example, the SEC accused Office Depot Inc. of improperly disclosing material information to financial analysts in 2007, which the company settled last year without admitting or denying guilt.

But when Office Depot filed a claim for more than $23 million from National Union Fire Insurance Co. of Pittsburgh, Pa., the Chartis unit acknowledged its obligation to pay the defense costs for SEC subpoenas and Wells Notices served to officers and directors, and for costs incurred in defending the various securities lawsuits, but not for a previous internal investigation and audit costs.

In October, a federal judge in West Palm Beach, Fla., ruled that the policy's definition of loss did not cover those claims, according to court documents.

"There was this recurring problem that the policyholders thought and expected (the entity's investigation costs) to be covered. It has certainly been my experience that that can be a very contentious issue," Mr. LaCroix said.

"The frustration was, these expenses that (they are) incurring in responding to the SEC are related, they are identical to the conduct that's the subject of the (SEC Rule) 10b-5 suit by the shareholder class action," Mr. Shappell said.

To address this gap in coverage, Chartis introduced Investigation Edge, which covers the entity during informal or formal investigations, experts say.

Risk managers are approaching their brokers about similar coverages, citing concerns that SEC investigations will intensify, experts say.

Chartis created Investigation Edge in part to respond to the heightened regulatory scrutiny that followed the credit crisis, said Brady Head, president of executive liabilities in the corporate accounts group for Chartis in Houston.

In addition, last year's Dodd-Frank Wall Street Reform and Consumer Protection Act expands the SEC's oversight requirements and includes financial incentives for whistle-blowers likely to spur more suits against public companies, Mr. Head said.

Still, the Investigation Edge takeup rate has been minimal, experts say, due mainly to its cost and the difficulty in determining how much cover to buy.

David M. Goldstein, senior vp of the executive risk practice for Willis North America in Boston, estimated the price for Investigation Edge to be between $30,000 to $60,000 per $1 million of coverage with a minimum retention of $500,000 and a 15% coinsurance requirement.

As D&O buyers look to control their insurance costs and expenses, it's a tough sell, Mr. Goldstein said, which could keep other insurers from offering the coverage right away. But he expressed confidence that they will respond in time.

"I think most carriers at this point are waiting to see what the uptake is on Investigation Edge first so that they can judge the client community response, the kind of pricing Chartis is getting for it, see where the weaknesses are and then they'll respond," Mr. Goldstein said.

No other insurer offers a policy addressing the entity's SEC investigation costs, experts say.

Steve Boughal, vp of Hartford Financial Products, a unit of Hartford Financial Services Group Inc., said that while these particular D&O liability exposures are complex with limited to no coverage available in the marketplace, "we're always looking at what we need to do to meet clients' needs; and in light of proposed regulatory changes, we're always looking at what we can do to enhance our policy.

"We're evaluating regulatory investigations as it relates to the entity," he said.

Aon's Mr. Shappell said there may be some challenges to the Chartis coverage. For example, because it is a separate policy, it may lead to fund allocation fights that are inherent when two policies could respond to the same claim.

Either way, Chartis' entity coverage is "teeing up the issue for a more in-depth discussion with our clients," Mr. Shappell said. "It forces a greater appreciation of this challenge for carriers not wanting to cover the costs incurred by the entity for SEC investigations."

ENFORCEMENT ACTIONS

Since fiscal 2004, enforcement actions taken against companies under the Securities Exchange Act have resulted in penalties totaling more than $5 billion.

Fiscal year	Enforcement actions	Profits disgorged	Penalties paid
2010	681	$1.82 billion	$1.03 billion
2009	664	$2.09 billion	$345 million
2008	671	$774 million	$256 million
2007	656	$1.09 billion	$507 million
2006	574	$2.3 billion	$975 million
2005	630	$1.6 billion	$1.5 billion
2004	639	$1.9 billion	$1.2 billion

Source: Securities and Exchange Commission

ARCHITECTS & ENGINEERS LIABILITY

Green building design teams face increased exposures

Contract guarantees on LEED designation create liabilities

By JOANNE WOJCIK

An architectural firm agrees to design an office building to achieve Leadership in Energy and Environmental Design gold certification, the second-highest level of the U.S. Green Building Council's sustainability design scale.

Meanwhile, the developer that hired the architect advertises the project as having significantly reduced operating costs and a healthier work environment than traditional office buildings, hoping to charge higher rent.

However, when budget and time constraints prevent achievement of the desired LEED certification level, the developer sues the architect for negligence, breach of contract and breach of warranty based on the architect's "guarantee" of LEED gold certification.

On an unrelated project, a team of architects agrees to design a condominium complex using sustainability attributes necessary to qualify for the state's green building tax credit program. But when the project's completion is delayed past the deadline for obtaining the tax credit, the project owner sues the design team and the developer for the loss of the tax credit, citing negligence and breach of contract.

Both of these actual claims scenarios could have been prevented had the design professionals not promised the achievement of specific LEED certification levels, experts in construction risk management say.

Fortunately, some insurers, such as Boston-based Lexington Insurance Co. and Bermuda-based XL Insurance Co. Ltd., have amended their architects, engineers and contractors professional liability policies to respond to claims associated with projects seeking LEED certification.

8,900

As of May 10, there were about 8,900 LEED-certified building projects in the United States encompassing 1.3 billion square feet.

In addition, New York-based Chartis Inc., Lexington's parent company, recently introduced Green Reputation Coverage, which helps mitigate the impact of adverse publicity and defense costs should a building fail to meet green industry standards.

Legal disputes growing

Although the economic downturn has slowed all construction during recent years, green building-related legal disputes are expected to grow as high energy costs and new building codes increase demand for LEED-certified and other types of energy-efficient buildings, professional liability experts predict.

As of May 10, there were about 8,900 LEED-certified building projects in the United States encompassing 1.3 billion square feet, according to Susan Dorn, general counsel of the Green Building Council.

"Everything is being built with energy conservation in mind," said Frank Musica, senior risk management attorney at Victor O. Schinnerer & Co. Inc. in Chevy Chase, Md. "As governments start hinging more benefits, such as tax credits, on third-party certification programs like LEED, the risks increase," he said.

Already, 34 jurisdictions have made LEED certification a mandatory requirement for certain buildings in their community.

For example, under Washington's 2006 Green Building Act, developers of nonresidential buildings exceeding 50,000 square feet after Jan. 1, 2012, will be required to post a bond that their projects will meet or exceed LEED certification.

This requirement will be difficult, if not impossible, for developers to meet, Mr. Musica said, because no surety bond underwriters will offer such guarantees.

See LEED page 17

NUMBERS GROWING

Number of commercial LEED-certified and -registered projects, per year

Year	Projects: Certified	Projects: Registered
2000	5	8
2001	5	71
2002	21	142
2003	46	181
2004	117	321
2005	201	692
2006	320	931
2007	541	3,961
2008	977	7,187
2009	2,318	10,375
2010	3,134	8,030
2011	1,222	3,552

Source: U.S. Green Building Council

MEDICAL MALPRACTICE LIABILITY

More doctors, risks in the house under health care reform

As staffs increase, hospitals expected to use captives more

By RODD ZOLKOS

Pressure on hospital and health care systems to add physicians as a result of the federal health care reform law will prompt dramatic growth in the use of alternative risk transfer vehicles to address medical professional liability risks, many experts say.

The pressure on hospitals to add physicians to their staffs is expected to be twofold. Hospitals will be looking to meet the added demand of the 32 million previously uninsured U.S. residents expected to obtain coverage through the program. In addition, health care facilities, looking to benefit from new outcome-based reimbursement policies in the law, are expected to bring previously independent physicians on board as employees, increasing their liability exposures in the process.

Hospitals will look to add physicians to meet the added demand of the 32 million previously uninsured U.S. residents affected by the health care reform law, experts say.

"A hospital already has in its captives whoever its employed physicians are," said Michael Maglaras, president of consultant Michael Maglaras & Co. in Ashford, Conn. "What we'll see is growth in one aspect of hospital captives and that is the physician risk they take on."

"The old bifurcation of the hospital having its own insurance through the captive and 'Dr. Maglaras' buying his coverage through an insurer…that paradigm is going to shift," said Mr. Maglaras.

Captives likely to grow

Michelle Hoppes, president of the Chicago-based American Society for Healthcare Risk Management, said most large health care systems "already do have captives set up for this type of risk and absolutely do plan to utilize them to address this additional risk."

Health care facilities that don't have captives certainly will consider whether an alternative risk transfer approach offers advantages over the traditional market as they look to address the exposure they'll add by bringing those physicians on staff, said Ms. Hoppes, who is senior vp and national director of health care risk management and patient safety at Sedgwick Claims Management Services Inc. in Troy, Mich.

"That's absolutely the discussion that's happening now," Ms. Hoppes said.

As the impact of health care reform takes hold, what's now "a quiet sleepy side of our business"—single-parent hospital captives—will become "a hotbed" of activity, Mr. Maglaras said.

See REFORM page 17

DIRECTORS & OFFICERS LIABILITY

Few emulate Buffett's strategy on D&O exposure

But lack of coverage doesn't seem to deter Berkshire directors

By SONJA RYST

Warren Buffett does not buy directors and officers liability insurance to protect executives at Berkshire Hathaway Inc. from job-related lawsuits, but experts say such an approach works only for the wealthiest companies.

The Oracle of Omaha in recent months said the directors who represent his investors think and act like owners. "If they mess up with your money, they will lose their money as well," Mr. Buffett said in his 2010 annual report.

While Mr. Buffett has not bought D&O coverage in decades, Berkshire's Wayne, Pa.-based specialty insurance firm, United States Liability Insurance Group, sells it. But when Mr. Buffett takes an ownership stake in a company, he does not renew that business unit's D&O coverage, sources say.

Still, Mr. Buffett recognized in his annual report that providing some form of D&O coverage is "a given at almost every other large public company," and experts agree.

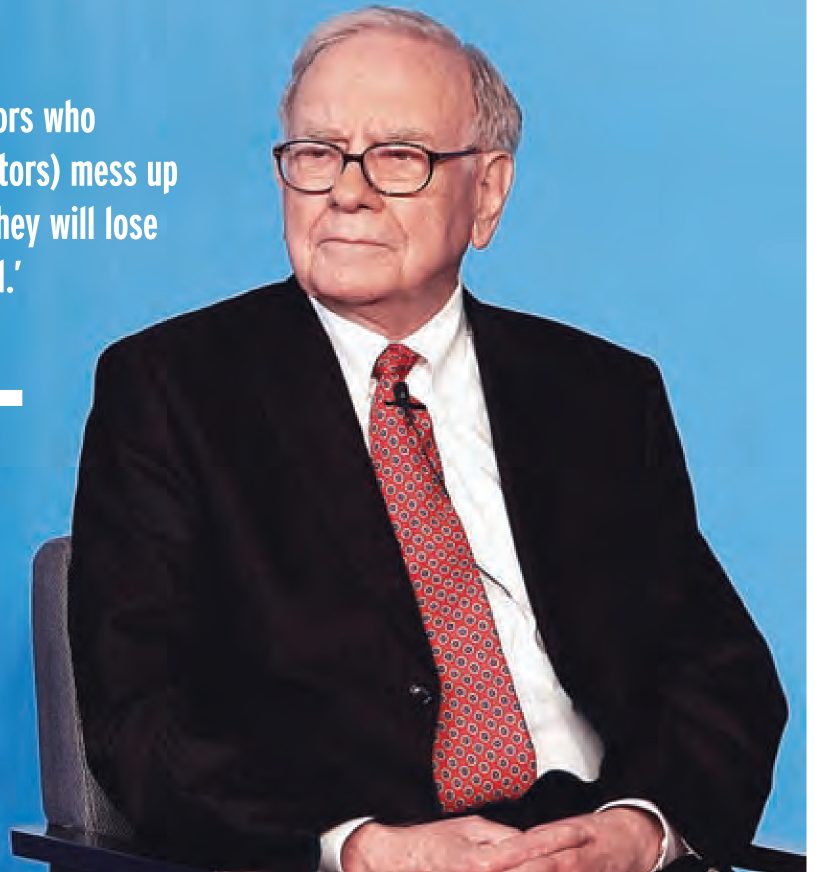
"It's become so patently clear that directors are becoming more and more the targets of people who want to bring suits, or have some kind of reason to dislike what a corporation is doing," said Edgar Armstrong, managing member of Armstrong Insurance Consulting Services L.L.C. in Fairfax, Va. Given the environment, he said people would not want to put themselves at risk by serving on company boards without insurance.

'If they (the directors who represent his investors) mess up with your money, they will lose their money as well.'

Warren Buffett,
Berkshire Hathaway Inc.

$94B

Berkshire Hathaway Inc. said in its 2010 annual report that it had about $94 billion more on hand to meet insurance claims than required by law as of Dec. 31, 2010.



AP PHOTO

Backing talented people

D&O is "a way to give people of talent and vision the ability to serve the public that needs their service so badly," Mr. Armstrong said.

Despite the lack of D&O coverage, Berkshire's board includes former Yahoo! Inc. President Susan Decker and Microsoft Corp. Chairman Bill Gates.

"I don't think he loses anything" by not buying D&O, said Evan Rosenberg, senior vp and global specialty lines manager in Warren, N.J., for Chubb Group of Insurance Cos. He said the prestige of Berkshire's board allows Mr. Buffett to attract people to serve on the board, and Berkshire is strong enough financially not to have exposure to the risk of financial failure.

A company the size of Berkshire typically would have a deductible on its D&O policy of about $25 million, and Mr. Buffett might bet that the quality of people on his team are not likely to incur any legal expense exceeding such an amount, Mr. Rosenberg said.

Berkshire declined to comment officially.

D&O insurance promises to pay manager expenses in situations where the companies cannot, such as shareholder lawsuits or bankruptcy. Berkshire said in its 2010 annual report that it had about $94 billion more on hand to meet insurance claims than required by law as of Dec. 31, 2010.

'It's become so patently clear that directors are becoming more and more the targets of people who want to bring suits, or have some kind of reason to dislike what a corporation is doing.'

Edgar Armstrong,
Armstrong Insurance Consulting Services L.L.C.

Berkshire has "a tremendous amount of cash that they're sitting on, so they're large enough that they can probably self-insure," said Peter Gleason, managing director and chief financial officer of the National Assn. of Corporate Directors in Washington. "We always recommend that public company directors have D&O (coverage) when they serve on a board, simply because you're always going to get sued whether you're in the wrong or not. Lawsuits happen."

The potential damage of a lawsuit alleging mismanagement can vary widely depending on who gets involved and how long it lasts, but experts say costs can be in the hundreds of millions of dollars.

It remains to be seen how much costs will result from a lawsuit that Berkshire shareholder Mason Kirby filed in April alleging that 13 individuals, including Mr. Buffett's former key lieutenant David Sokol, breached their fiduciary duties. However, Lubrizol Corp. shareholders earlier this month approved Berkshire's acquisition of the Wickliffe, Ohio-based chemical company, despite allegations in the pending shareholder suit that Mr. Sokol bought shares in Lubrizol ahead of the offer.

D&O rates vary depending on factors such as the level of risk, but for large financial institutions premiums can range from $40,000 to $100,000 per $1 million in coverage, said Tripp Sheehan, Boston-based managing director and D&O practice leader at Marsh Inc.'s FINPRO U.S. practice.

A spokeswoman for Microsoft Corp. said the company also does not buy D&O coverage. She declined to discuss details, but said the company has other ways of insuring.

"I can see Warren Buffet's point, but I can also see how if you're running a more typical company, adhering to that philosophy might be difficult," said Jason Porter, a credit analyst at Standard & Poor's Corp. in New York. "In the general world because of the risk of litigation, it could be difficult to get the board members you want without the product."

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Demands at home create bias suits at work

New demographics, old stereotypes driving litigation

By JUDY GREENWALD

88%

Percentage of plaintiffs in family responsibilities discrimination litigation who are female. Their claims most often concern pregnancy and maternity leave.

Employers are growing more concerned about workplace discrimination lawsuits stemming from employees' responsibilities to their families.

Such lawsuits include any litigation relating to family caregiving responsibilities and cuts across sex, race and disability discrimination laws. Hiring, firing, pay, bonuses, promotions, time off and hostile work environments all can be factors in family responsibilities discrimination suits.

It covers issues surrounding firing a pregnant woman, refusing to promote a parent with young children, or failing to accommodate a worker's desire to leave early to pick up a child at school or take an ailing parent to the doctor.

Unlike other types of bias, discrimination due to family responsibilities does not fall neatly under any particular federal law.

Among federal laws that can come into play are the Family and Medical Leave Act of 1993, the Americans with Disabilities Act of 1990, the Pregnancy Discrimination Act of 1978, the Employee Retirement Income Security Act of 1974, Title VII of the Civil Rights Act of 1964, the Equal Pay Act of 1963.

According to the Center for WorkLife Law, only one state, the District of Columbia and some localities expressly include family responsibilities as a protected category in their employment discrimination laws. In addition, two other states and a federal executive order expressly prohibit some forms of family responsibilities discrimination (see box).

FAMILY RESPONSIBILITIES DISCRIMINATION LAWS

According to the Center for WorkLife Law, family responsibilities discrimination is prohibited under varying theories in current federal, state and local laws. To date, only one state, the District of Columbia and some localities expressly include family responsibilities as a protected category in their employment discrimination laws. Two other states and a federal executive order expressly prohibit some forms of family responsibilities discrimination.

ALASKA: The Alaska Human Rights Law includes "parenthood" in employment discrimination protections.

DISTRICT OF COLUMBIA: The District of Columbia Human Rights Act includes "family responsibilities" in its employment discrimination protections.

CONNECTICUT: The Connecticut Fair Employment Practices Act prohibits employers from requesting or requiring information relating to "child-bearing age or plans, pregnancy" or "familial responsibilities" from a job applicant or employee.

NEW JERSEY: The New Jersey Administrative Code protects state employees from employment discrimination on the basis of "familial status."

SIXTY-PLUS CITIES, COUNTIES: "Familial status," "family responsibilities," "parenthood" or "parental status" are included in employment discrimination statutes.

U.S. GOVERNMENT: A 1971 executive order that was amended in 2000 protects federal employees from employment discrimination on the basis of "status as a parent."

Source: Center for WorkLife Law

EEOC best practices

The U.S. Equal Employment Opportunity Commission has taken an active interest in this issue, experts say. In 2007 guidance, the agency explained circumstances under which discrimination against workers with caregiving responsibilities could constitute discrimination. It followed up in 2009 with suggested best practices for workers with caregiving responsibilities.

The number of family responsibilities discrimination suits increased from four in 1979 to 329 in 2008, according to "Family Responsibilities Discrimination: Litigation Update 2010" by the San Francisco-based Center for WorkLife Law.

The issue already has led to some substantial awards.

For instance, Novartis A.G. last year agreed to pay $175 million to settle a class action that accused the Swiss pharmaceutical firm of unfair treatment of 5,600 female sales representatives regarding pay and promotion, which could be considered a family responsibilities bias suit, said Carolyn Rashby, an associate with the San Francisco-based Miller Law Group.

In another example in *Nancy Falco Chedid, M.D., et al. vs. Children's Hospital et al.*, a Massachusetts state court in May permitted a part-time doctor with children, who alleged she was not offered the same opportunity to work full time as a male colleague, to pursue a lawsuit in which she accuses her former employer of sex discrimination and unlawful retaliation.

There is "increasingly more emphasis on pursuit of these kinds of claims, both by the EEOC and by private plaintiffs," said Frank C. Morris Jr., a member of law firm Epstein Becker & Green P.C. in Washington.

"There's increased focus on the concept of family responsibility as a distinct form of discrimination," said Michele Ballard Miller, a shareholder at the Miller Law Group. "If you have two women vying for a particular job, and one woman doesn't get the job because there's a perception they might need time off" to take care of young children or an elderly parent, "10 years ago, people would look at that say, 'it can't be discrimination,'" but that was before family responsibilities bias became a recognized problem.

Demographics

Driving the growth is new demographics and old stereotypes, said Elaine S. Fox, of counsel with Seyfarth Shaw L.L.P. in Chicago. "You have people in the workplace that not only have to take care of their children" but their parents as well. Meanwhile, old stereotypes linger with regard to women in the workplace, she said.

A tight job market also could be a factor in the increased litigation, Mr. Morris said.

The litigation increase reflects "a lack of awareness" on the part of employers, said Cynthia Thomas Calvert, senior adviser, family responsibilities discrimination, at the Center for WorkLife Law. While the EEOC has provided solid guidance, "I think a lot of it is not filtering down."

The 2007 guidance "was part of the EEOC's attempt to combine different statutes into consolidated workplace management policies, so employers were always aware of the need to avoid discriminating against people," said William A. Wright, a member of Sherman & Howard L.L.C. in Denver.

According to the WorkLife study, 88% of plaintiffs in family responsibilities discrimination litigation are female, and their claims most often concern pregnancy and maternity leave.

Many cases involve women in nontraditional jobs, including police officers, said Ms. Calvert, "but we still see the cases arising in every industry and at every level within a company," and there has been an uptick in cases filed by men, she said.

Ms. Rashby said employers should examine their policies to make sure they do not reflect any inherent biases. Experts also suggest employers revise their policies to expressly forbid family responsibilities discrimination.

Companies should develop flexible work schedules "in a way that makes it clear the extent to which employees can have families and can participate in their family activities while still being fully productive employees," said Mr. Wright.

While training also is important, numerous laws that may be involved can complicate addressing the issue. "It means that you do have to train the employees with the use of a number of real-life examples of how people find themselves with different kinds of family responsibilities," said Mr. Wright.

Marc A. Antonetti, a partner with Baker & Hostetler L.L.P. in Washington, said manager training "would help mitigate against any precipitous action being taken against an employee without considering how FRD might come into play."

Questions and treatment of employees should be gender-neutral, experts say.

George L. Lenard, a partner with Harris Dowell Fisher & Harris L.C. in St. Louis, said if an employer asks anyone questions about working long hours and travel, "you need to be asking everybody that." Asking a woman if she has children "isn't complete proof of gender discrimination, but it's not something I want to have in a case I'm defending," he added.

Also, if a male employee is given permission to leave early once a week to coach Little League, a female worker also should be permitted to leave early to take her child to baseball practice, Mr. Lenard said.

Randy Enochs of the Glendale, Wis.-based Enochs Law Firm, who primarily represents plaintiffs, said employers need to "really engage with the employee on what can be done to accommodate them." Employers "need to make sure they really speak with the employee at length about how much time they need off" and related issues, he said.

Firms should have an internal complaint mechanism in place when these issues arise, experts say.

DIRECTORS & OFFICERS LIABILITY

As deals take off, D&O issues follow

By SARAH VEYSEY

As the global economy continues to recover from the recession, experts say 2011 may be "the year of the merger."

M&A activity picked up last year since slumping in 2008 and 2009 as the world's financial markets suffered along with the economy. And M&As pose key challenges for risk managers, particularly in arranging directors and officers liability coverage for firms that may have very different cultures.

That means that risk managers should play an active role in due diligence, experts say.

Risk managers of large corporations are participating in due diligence efforts more frequently and often can access the "data room" of the target company to review its insurance coverage, said Paul Bluck, client director in Aon Corp.'s financial services group in London.

More "enlightened" risk managers have become engaged in the big decisions that their companies are making in M&As or expansion, said John Scott, chief risk officer of the global corporate business of Zurich Financial Services Group in London. By doing so, a risk manager can influence the success of a merger, Mr. Scott noted.

M&A-related litigation is one of the "flashpoints" for D&O claims and heightened exposure, said Jeff Grange, chief underwriting officer of global professional lines at Torus Insurance Group in Jersey City, N.J.

As M&A activity increases amid the potential for antitrust claims and stricter regulatory requirements in some jurisdictions, the scope for M&A-related D&O claims increases, said Kenneth Fekete, vp, U.S. management liability at Torus in Jersey City.

Risk managers are more aware of the need to meet with top-level executives to ensure the company gives transparent, accurate information to underwriters, said Mr. Grange.

Risk managers need to assess D&O exposures before and after a merger, said Rupert Alabaster, a director in the wholesale professional and financial services team at brokerage BMS Group Ltd. in London.

To help risk managers assess their pre- and post-merger D&O strategy, brokers can assist in due diligence and help ensure there are no coverage gaps when the M&A is complete, Mr. Alabaster said.

Risk managers and their advisers need to communicate effectively with senior management teams and "hold their hands through any changes to D&O program structure, limits and coverage," he said.

AP PHOTO

M&A deals, such as the Southwest-AirTran merger, can create D&O insurance complications.

Two airlines' experience

The acquisition of Orlando, Fla.-based AirTran Airways by Dallas-based Southwest Airlines Co., which was completed in May, posed several D&O challenges for Chris Thorn, Dallas-based risk manager, corporate insurance for Southwest.

Mr. Thorn said that because airline companies tend to be fierce competitors and that it is possible the deal may not happen, it is difficult for a risk manager to get information about the insureds at the target company.

The only real source of information might be the merger agreement, which tends to offer a very broad indemnification for directors and officers of the target company, he said. The acquirer may not wish to offer such broad indemnification, and its insurance may not offer such broad coverage, he said.

Risk managers need to ensure that their board understands the breadth of the indemnity they pledge to the directors and officers of the target company, he said.

"It is not just a case of buying a policy," he said. There may be gaps between the indemnity offered and the insurance, "and you have to stand behind any exclusions," he said.

The Southwest-AirTran merger agreement stated that the D&O liability coverage provided to directors and officers of AirTran—after the acquisition and for liabilities going back six years—should be "at least as favorable" as that provided in AirTran's pre-existing D&O policy, said Peter R. Taffae, founder of Los Angeles-based Executive Perils Inc., which advised Southwest.

To ensure there were no gaps in coverage, and that the directors and officers of both airlines were comfortable with the level of coverage, Executive Perils in May designed a new structure of D&O coverage known as "trilateral coverage," said Mr. Taffae.

The coverage offered by AirTran's existing insurer was not deemed appropriate by Southwest, which is covered by a different insurer, he said. While it is possible to buy endorsements to existing coverage, it is virtually impossible to ensure that it is "at least as favorable" as that provided by the target company's existing insurer, he said.

So Executive Perils sourced another insurer to provide an endorsement stating that in the event of a claim, the policy would be no less broad than the coverage offered by AirTran's expiring insurance.

In the event of a claim, two insurers are providing coverage to AirTran's directors and officers and, depending on the nature of the claim, the most favorable wording from each policy will be used, he said.

> **'It is quite important to get a good idea of expectations from the outset.'**
>
> Adam Codrington, Jardine Lloyd Thompson Group P.L.C.

Expectations that directors and officers of merging companies have of their D&O insurance coverage often differ from those of the acquiring company, Mr. Alabaster said.

One challenge facing D&O underwriters when companies merge is that acquiring companies frequently have clauses that give automatic coverage to directors and officers of the acquired company, said Mr. Alabaster. This may mean underwriters do not have all the information about the acquired company's D&O coverage that they would wish to have, he said.

Differences in culture can mean that the way one company historically has dealt with D&O is quite different from the strategy of the other, particularly if one has had a claim, said Adam Codrington, executive director in the financial risks division of London-based Jardine Lloyd Thompson Group P.L.C.

"It is quite important to get a good idea of expectations from the outset," Mr. Codrington said.

While he agrees that coverage purchased by the acquiring company automatically often covers the directors and officers of the target company, Mr. Codrington said issues may arise of the coverage is not as broad as previously. Therefore, it is important for target companies to make those expectations clear during the due diligence process, he said.

It is common practice for the acquiring company to offer D&O coverage to the acquired company from the date of the sale and for previous liabilities of the acquired company to be insured in a runoff policy, said Mr. Codrington.

Sometimes, the purchase of such a runoff policy is a condition of the sale, he added.

Because some D&O coverage automatically is extended to include directors and officers of target companies, brokers and underwriters must understand whether their clients are likely to be acquisitive and factor that into the coverage, said Mr. Bluck. He said Aon talks to its clients regularly about whether they plan to change their M&A strategy.

Risk managers also need to look closely at the adequacy of any runoff D&O policies purchased by the target company, he said. Acquirers can purchase coverage for "prior acts" that would cover claims made against the target company before the acquisition, but typically acquirer clients want to be sure that they are not on the hook for any claims that may arise from actions taken before the acquisition, he said.

Additional challenges for risk managers arise when their company is involved in a deal to buy or merge with an overseas company, experts say.

Cross-border M&As are an area where risk managers need to ensure they understand how D&O coverage would respond, said Torus' Mr. Grange.

If an acquisition target is abroad, a master D&O policy may not respond in case of a claim. Therefore, risk managers must ensure that they are fully involved in due diligence and are able to plug any gaps in the coverage, he said.

While, on average, rates for directors and officers insurance are flat or even decreasing, there is a small "bubble of premium rate increases" for M&As involving Chinese companies purchasing U.S. companies, said Mr. Alabaster, after several actions brought by U.S. shareholders against Chinese companies because of alleged accounting and reporting irregularities.

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LEED: Building designers face increased exposures

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Moreover, even if such bonds become available, any financial commitment will be absorbed by the design firms and contractors, he said.

Unlike professional liability insurance in which an insurer pays claims, the entities performing the work are required to repay the bond guarantor the full amount, plus an additional fee based on a percentage of the contract's value, when a surety bond is triggered, Mr. Musica said.

"So if a project does not meet the LEED certification for any reason, such as the reviewer doesn't feel like certifying the final project or the developer runs out of money to pay for the certification or the contractor screws up the construction, huge costs will be passed on to design firms," he said.

Avoid guarantees

Because of the potential for liability, the Washington-based American Institute of Architects recommends that design professionals not guarantee that their projects will meet any type of LEED certification standards, said Edward B. Gentilcore, a partner at Duane Morris L.L.P. in Pittsburgh, who chaired a panel at the institute's April sustainability summit, which was held in conjunction with the Associated General Contractors of America. He also helped craft the Green Building Addendum, or industry-specific contract terms, that institute members can use.

In fact, guaranteeing LEED certification upon completion of a project would void coverage under most professional liability insurance policies, Mr. Musica said.

"Over the last few years, some architects have shot themselves in the foot. They'd rush in and sign contracts for a warranty for green design," he said.

Fortunately, the vast majority of such lawsuits also cited negligence or breach of contract, so there has been some coverage, said Stephen T. Del Percio, an attorney at Arent Fox L.L.P. in New York who focuses in such litigation.

"We strongly recommend that they never warrant or guarantee a certain expectation of a client, specifically LEED certification," said Albert Rebasca, director of industry relations at XL Group P.L.C. in Bloomfield, N.J.

Heeding the advice of his professional liability insurer, XL, "we don't warrant or certify that we're going to give them a LEED building. We simply say our goal and our best efforts are to get them the LEED certification they request," said Michael Kaufman, a partner at building design firm Goettsch Partners Inc. in Chicago.

"The label of 'green' is being thrown around with such ubiquity that, in some respects, it's getting lost that there is some responsibility associated with representing that these buildings are going to be the best, the brightest, the most energy efficient," Mr. Gentilcore said.

'Over the last few years, some architects have shot themselves in the foot. They'd rush in and sign contracts for a warranty for green design.'

Frank Musica, Victor O. Schinnerer & Co. Inc.

Moreover, under the latest LEED certification standard, which requires that building performance data be reported to the Green Building Council each year for three years after completion, building owners and operators could be put in the same precarious position as architects and contractors.

Whenever there's a green project, "everyone's responsibility is enhanced," said Robert Stanton, vp-risk management at Willis Group Holdings P.L.C. in Chicago.

Contractors also could face additional liability if they decide to substitute building materials to cut costs or because the green components included in the design are not readily available, Mr. Stanton said.

"We have had a claim for a building specifying a new product not yet available," said Bob Rogers, vp at Lexington in Boston. The claim sought reimbursement for the increased cost associated with obtaining an alternative product, he said.

"There's also an associated risk with using green materials that may not have proven effectiveness or durability," Mr. Stanton said.

"Right now, one of the best things design firms can do is keep their professionals on the cutting edge in terms of continuing education and also make sure they coordinate with their legal departments about the potential liabilities they face," said De'andre Salter, CEO of Professional Risk Solutions, a wholesale broker and risk management consultant based in Warren, N.J. He also recommends that design professionals be careful in selecting the independent contractors and subcontractors they use.

"If you don't thoroughly vet them and (you) put them on a project and something goes wrong, you're going to be pulled into the lawsuit," Mr. Salter said.

Reform: More doctors in the house under health law

CONTINUED FROM PAGE 13

"I just left a captive board meeting in Bermuda where one of the issues on the table was the recruitment of 200 new physicians in the next couple of years," he said, underscoring what he said will be a "paradigm shift" for an exposure group that historically has been self-employed and insured in the traditional market that will move toward being hospital employees insured by their employers.

In addition to captives, experts say they expect more use of risk retention groups to cover the exposure.

Adding to the impact on hospitals and their captives is that the change will come against a backdrop of an already competitive environment for health care professionals.

"There are a lot of things that we deal with, the first being that we already don't have enough health care providers," said Vivian Miller, Chicago-based senior risk management specialist at ASHRM. "To get health care providers to come on board in that community…nine times out of 10 the only way we're going to be able to keep them is to cover their insurance cost."

That can apply to physicians employed by the hospital or self-employed physicians whose insurance the hospital agrees to subsidize through its own coverage to get them to affiliate with the hospital, Ms. Miller said.

'There are a lot of things that we deal with, the first being that we already don't have enough health care providers.'

Vivian Miller, American Society for Healthcare Risk Management

The hospital can provide that coverage through traditional markets or a captive, though "captives are becoming much more popular for a variety of reasons," Ms. Miller said.

While there are the initial costs of funding a captive, Ms. Miller said that, because claims typically don't mature for several years, the captive can be less expensive than traditional insurance in the early years. And, she noted, a hospital likely will see its premiums increase as a result of claims when using traditional insurance.

Saving money

"A lot of times, that captive—if you're not spending that money because it takes a couple of years for those claims to mature—you can make money on the deal because of your investments," Ms. Miller said. "So there's a significant advantage. There's also a significant advantage to having a higher retention."

A key consideration is that doctors already in practice typically come with a tail of exposures, Mr. Maglaras said. "Someone is going to have to acquire that liability," he said.

"One option is for the hospital to say, 'We want to have you, but you've got to buy tail insurance,'" he said. However, that might become an area of competition among hospitals vying for the same physicians, with some offering to take on that tail exposure in its captive.

Particularly in hot health care markets, "these captives as a result will get big. More exposure, more liability, more need for service providers. Perhaps higher reinsurance limits," Mr. Maglaras said. "Service providers will be extremely busy."

The change will affect captive assets, capital and surplus, domicile decisions, service needs, reinsurance, net retentions, and the infrastructure the hospitals need to provide risk management education to physicians who previously received that training from traditional insurers, according to Mr. Maglaras.

"Captive budgets will increase as a result because there is a larger base of people that need their services," he said.

Ms. Miller agreed that hospitals will need to provide various risk management training services to physicians joining their staffs, but said that if they address those risks through a captive, typically the third-party administrator employed by the captive can provide that education in conjunction with the hospital's safety officer and risk management staff.

She also noted that, as in other industries, by taking more control over their risk in captives, hospitals also can improve their loss experience.

That's been the experience with existing hospital captives, said David F. Provost, deputy commissioner in the Captive Insurance Division of the Vermont Department of Banking, Insurance, Securities and Health Care Administration. Those captives "have been a steady line of business for us," he said. "And it's really been very successful for the hospitals, too. The ones that have done this have seen improvements in patient safety and patient results because of what they've done."

Ultimately, there will be "enormous growth of captives because of health care reform," Mr. Maglaras predicted. "It's happening now."

Mr. Provost said that while he hasn't yet seen the impact of health care reform on captive use, "they all seem to be saying there ought to be some sort of increase," adding, "we'll be ready for them."

LARGEST SETTLEMENTS

The 10 largest securities class action settlements, as of year-end 2010, in billions of dollars

COMPANY	YEAR	TOTAL VALUE
ENRON CORP.[1]	2010	$7.24
WORLDCOM INC.[2]	2005	$6.16
CENDANT CORP.[3]	2000	$3.56
TYCO INTERNATIONAL LTD.	2007	$3.20
AOL TIME WARNER INC.	2006	$2.65
NORTEL NETWORKS (I)	2006	$1.14
ROYAL AHOLD N.V.	2006	$1.10
NORTEL NETWORKS (II)	2006	$1.07
McKESSON HBOC INC.	2008	$1.04
AMERICAN INTERNATIONAL GROUP INC.[4]	2010	$1.01

1 Includes eight partial settlements. 2 Incorporates $1.6 million settlement in MCI WorldCom TARGETS case. 3 Incorporates $374 million settlement in Cendant PRIDES I and PRIDES II cases. 4 Includes one partial settlement and three tentative settlements.
Source: NERA Economic Consulting

Tighter rules may spur mismanagement claims

Tougher regulations on disclosing corporate risk might spur additional securities fraud class actions alleging mismanagement, some experts say.

"There is a worldwide shift" toward holding directors and officers more responsible for operational problems, said corporate attorney Heidi A. Lawson, a partner with Chadbourne & Parke L.L.P. who splits her time between New York and London.

Ms. Lawson said the Securities and Exchange Commission last year issued a new rule requiring companies to increase or modify disclosures about their boards' role in risk oversight. In addition, the SEC rule is far broader than Dodd-Frank Wall Street Reform and Consumer Protection Act, which imposes new risk disclosure provisions on large financial institutions.

Those new regulations come atop a body of case law in Delaware—where more than half of publicly traded U.S. companies are incorporated—that bars companies from indemnifying corporate officials who fail to exercise appropriate risk oversight.

In the United Kingdom, meanwhile, the Walker Review—a government-commissioned examination of corporate governance at financial institutions—recommended in 2009 that the organizations appoint board-level risk officers to ensure their boards obtain unfiltered information about the organization's risks.

A few U.K. companies have adopted the recommendation, but more are creating board-level risk committees, Ms. Lawson said.

The new SEC rule "peeks in that direction" by encouraging U.S. boards "to think about how they would do it," she said.

So even if corporate defendants do not issue misleading financial statements that affect securities trading—a leading driver of securities fraud cases—growing regulation means corporate officials face more chances to make mistakes that would trigger securities fraud litigation, she said.

"I don't disagree with that," said Steve Shappell, Denver-based global managing director of legal and claims at Aon Financial Services Group, a unit of Aon Corp.

The challenge for companies when deciding to disclose risk is determining "what's enough," he said. "Companies are constantly struggling with that. I don't think there's a silver bullet" for determining how much disclosure is adequate.

—By Dave Lenckus

Shift: Significant changes seen in shareholder suits

CONTINUED FROM PAGE 3

"There's definitely an evolution going on in the claims being filed" over M&As, said broker and attorney Kevin LaCroix, executive vp at OakBridge Insurance Services L.L.C. in Beachwood, Ohio.

Most M&A and mismanagement cases are filed in state courts as derivative actions because they do not allege that corporate officials affected securities trading by defrauding or manipulating investors in violation of the Securities and Exchange Commission Rule 10b-5. In *Santa Fe Industries Inc. et al. vs. S. William Green et al.*, the U.S. Supreme Court ruled in 1977 that those are the only shareholder claims federal courts can hear.

But some plaintiffs in M&A cases sue in federal court by alleging misrepresentation, for example, in proxy materials, attorneys noted.

Defendants typically resolve derivative cases quickly by paying plaintiff attorneys' fees, modestly boosting the share price that plaintiffs receive in a merger or modifying a company practice, attorneys say.

Some plaintiffs in securities fraud class actions also have filed "tag-along" federal and state derivative actions, said R. Damian Brew, New York-based managing director of the FINPRO practice and national claims advocacy practice leader at Marsh Inc.

"But now, those cases are front and center," he said, noting that many recently have settled for relatively significant sums.

The five largest derivative action settlements ever—all reached since November 2005—range from $90 million to $900 million, according to Mr. LaCroix's D&O Diary blog.

"I do think we'll see more activity arising out of derivative actions and mergers and acquisitions," Mr. Brew said.

Mismanagement claims

Some factors, however, suggest that plaintiffs will look to mismanagement securities fraud claims more eagerly.

Shareholders can be discouraged from filing state court derivative actions by their statutory obligation to demand that "independent"—or innocent—board members conduct an investigation to determine whether a lawsuit should be filed, said Dan A. Bailey, a member of Columbus, Ohio-based law firm Bailey Cavalieri L.L.C.

Shareholders can circumvent that obligation by contending their demand would be futile because no board member is independent, he said.

While most shareholders raise that argument so they can file derivative actions themselves, 20% to 30% of derivative actions do not survive the board investigation stage, Mr. Bailey said.

In addition, securities fraud class actions typically are more lucrative than M&A cases, settling for millions and sometimes billions of dollars (see chart).

From 1996 through 2001, the average securities litigation settlement was $11.9 million while the average settlement from 2003 through 2010 was $30.4 million, excluding settlements greater than $1 billion and initial public offering-related litigation, according to NERA (see chart, page 19).

But plaintiffs in those cases are facing sharply higher dismissal rates under the stricter pleading standards the U.S. Supreme Court imposed in recent years, attorneys and brokers said. Considering that most cases take three to five years to resolve, 41% of cases filed in 2008 have been dismissed, while 43% remain active, according to the Securities Class Action Clearinghouse. In comparison, 33% of cases filed in 2001 were dismissed, with just 1% unresolved.

Many D&O liability experts say that all adds up to plaintiffs sticking with securities fraud class actions but finding more causes of action—such as mismanagement.

Continued on next page

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But for mismanagement cases to survive in federal court, plaintiffs must demonstrate that corporate officials deceived shareholders through a misleading statement that, upon disclosure, triggered a material drop in share price, legal experts said.

Otherwise, those cases would fall under the purview of state courts. There, unlike in federal court, defendants can rely on the business judgment defense that they are not liable for poor business outcomes based on actions they took within their authority and in good faith.

A plaintiff can claim in "any mismanagement case" that a defendant did not disclose some information, Mr. Bailey said. But that would make the Supreme Court's ruling in *Santa Fe* "meaningless," he added.

D&O experts who expect that more shareholder fraud class actions will center on operational blunders cite several recent examples, including lawsuits last year against BP P.L.C. over the Gulf of Mexico oil spill, Massey Energy Co. after a deadly coal mine explosion and Toyota Motor Corp. over its vehicles' acceleration and braking system problems.

Some observers, however, are not convinced a dramatic shift in claims in securities fraud class actions is under way.

OakBridge's Mr. LaCroix said shareholders filed securities fraud claims over operational problems years ago. Pharmaceutical companies have been prime targets in the past, he said.

Randy Hein, vp and quantitative analytics manager for the Chubb Group of Insurance Cos. in Warren, N.J., said that while mismanagement claims are rising and financial misrepresentation cases are decreasing, that does not indicate a material shift of mismanagement claims to federal courts.

Mr. Hein also noted the number of federal securities fraud class actions is not increasing.

In fact, he said, pointing to the growing state of M&A litigation: "I think plaintiffs are trying to get into state court" because of the growing difficulty of pressing federal securities fraud claims.

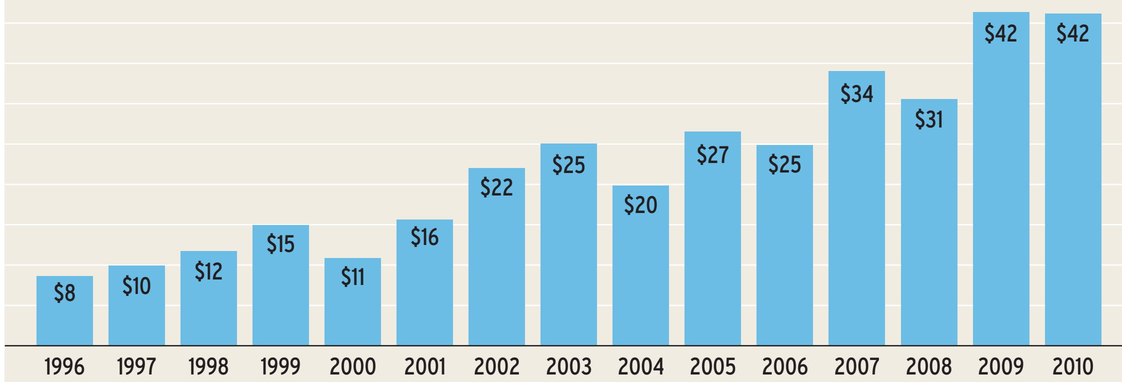
Securities fraud plaintiff attorney Carol V. Gilden, past president of the Washington-based National Assn. of Shareholder and Consumer Attorneys, also does not see a shift in claims.

"A financial restatement is all over the news immediately and for that reason, one will see class action suits fairly quickly," said Ms. Gilden, a partner at Cohen Milstein Sellers & Toll P.L.L.C. in Chicago.

"Frauds relating to operational issues can be more nuanced and often take a deeper analysis to uncover and demonstrate. They do not always catch the same amount of press," she said. "To the extent that companies disclose product deficiencies, this combined with other operational type disclosures may make it appear that these types of suits are on the rise. Rather, the number of financial restatements has dropped, and therefore so has the number of cases arising out of these events. For that reason, the contrast seems more stark."

SECURITIES LITIGATION SETTLEMENTS

The average value of settlements, excluding those of $1 billion or more and 309 related to initial public offerings, was $11.9 million from 1996 through 2001 and $30.4 million from 2003 through 2010, in millions of dollars.



Source: NERA Economic Consulting

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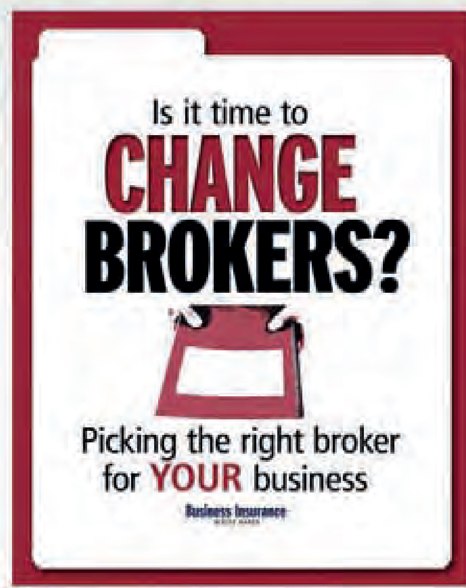

Is It Time To Change Brokers?
Picking The Right Broker For Your Business

Executives at many middle-market companies are very comfortable with their insurance brokers. For some, their broker seems like part of the corporate family, for others the executive in charge of insurance has other jobs and is too busy to analyze broker performance. Sometimes the broker is a family member or friend. But shouldn't this key corporate advisory role be subject to more rigorous scrutiny? This *Business Insurance* white paper examines the role that brokers play for middle-market firms, how executives at these firms should measure broker performance, and what they should look for in a broker if they believe it is time for a change.

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What is behind soft and hard insurance markets, how did we get where we are today, and what may lie ahead? John Chace, chief underwriting officer for OneBeacon Professional Insurance, takes a look at the different philosophies and positions companies take to underwrite profitable business throughout the market cycles.

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Private: Why buy D&O cover?

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public shareholder obligations, a private or nonprofit company's biggest exposure is likely to be claims filed by its own employees, he said.

In its 2010 analysis of the D&O market, New York-based Towers Watson & Co. said 67% of the claims filed in the past 10 years against charitable companies it surveyed were "employment related," as were 45% of the claims filed against private firms.

"Employment-related litigation is really at a historic level," said Larry Racioppo, New York-based head of Towers Watson's executive liability practice, citing the number of discrimination charges reported to the federal Equal Employment Opportunity Commission at the end of fiscal 2010. Just less than 100,000 employment-related suits were filed during the period, which the EEOC said is the highest in its 47-year history.

Mutually beneficial

Multicoverage products, he said, often appeal to the needs of cash-strapped private and charitable buyers in the middle-market sector. They also can reduce the administrative burden for the underwriter, resulting in more competitive premiums.

"Public companies often bifurcate those exposures because they don't want one to erode the other," Mr. Racioppo said. "But in that bundling, you can put together a pretty manageable coverage program from a price standpoint."

That is not to say private and nonprofit companies don't face exhausting their bundle's aggregate limit due to a potential claim against one line of coverage. Because their policy is packaged with other liabilities, many middle-market private and nonprofit firms choose not to use excess Side A D&O coverage—protection for the individual directors' and officers' personal assets against litigation fees and payouts stemming from accusations of wrongdoing—which could leave a company and its leadership vulnerable to crippling losses should there be multiple claims in the same policy period.

According to the Towers Watson analysis, 78% of surveyed private companies with less than $1 billion in assets do not use excess Side A coverage. However, indications are that the appetite for excess Side A coverage in the middle market is growing.

"Buyers in the private market are becoming more sophisticated, mostly because of the possibility of the erosion of the limit," said Diane Gardner, a senior vp at New York-based brokerage Marsh USA Inc.

More education needed

Even so, the Towers Watson survey found that 22% of private companies surveyed and 35% of nonprofit organizations didn't know how their D&O policies were structured. The survey's authors said the findings suggest that "brokers and other management liability consultants need to spend more time educating their nonprofit and private company clients about their D&O insurance purchase."

Asked for a market forecast for private and nonprofit middle-market companies, brokers and insurers said an overabundance of underwriters offering D&O coverage has kept premiums low and the scope of coverage wide. However, some said renewal rates—which had seen annual reductions as low as 25% in certain industries—are beginning to flatten, mostly because many insurers want to make certain the business is profitable.

Other factors that could contribute to a firming of middle-market rates in the near future for private and nonprofit companies, several brokers said, include settlements from pending employment practices-related litigation, unanticipated effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act and, perhaps more immediately, according to one market executive, unabated inflation in legal fees.

"That inflation has been significant over the last few years," said Andy Doherty, a senior vp at Willis HRH in New York, a unit of Willis Group Holdings P.L.C. "It hasn't necessarily impacted the premium end yet, because the competition in capacity overrides it, but it's something that carriers are monitoring because it erodes the deductibles much quicker."

IDENTIFYING RISKS

Whether they are concerned about exposures to shareholder or debt holder claims, directors and officers of private companies and nonprofit organizations should be aware that an array of other types of claimants could threaten their assets, said John LaBarbera, a Chicago-based member in the global insurance group at Cozen O'Connor P.C. Some sources of the most immediate risks include:

FOR PRIVATELY HELD COMPANIES

- **EMPLOYEES:** Discrimination, wrongful termination, retaliation, invasion of privacy, harassment
- **CLIENTS AND CUSTOMERS:** Failure to deliver services, poor product performance, misleading or misrepresentative statements, breach of contract
- **COMPETITORS:** Unfair trade practices, interfering with a contractual relationship, violation of anti-trust laws, intellectual property infringement
- **FELLOW DIRECTORS, MINORITY SHAREHOLDERS AND DEBT HOLDERS:** Breach of fiduciary duty, mismanagement or acting against the best interest of the company

FOR NONPROFIT ORGANIZATIONS

- **VOLUNTEERS:** Risk profile similar to employees, including discrimination, wrongful termination, retaliation, invasion of privacy, harassment
- **GOVERNMENT REGULATORS:** Misappropriation of funds or failure to return unused money back to the government, violation of applicable laws
- **THIRD-PARTY ENTITIES (SUPPLIERS, PROVIDERS, OTHER NONPROFITS):** Interfering with a contractual relationship, intellectual property infringement, breach of contract
- **DONORS AND BENEFICIARIES:** Misuse of donated funds, misrepresentation of the entity and/or its stated purpose

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Whistle: Rule adds to troubles

CONTINUED FROM PAGE 6

date and gauging how comfortable employees are that the program is truly independent.

Willis' Ms. Longmore said some might interpret robust reporting to mean zero tolerance. "It's more complicated than it sounds; zero tolerance for just about everything can be a dangerous thing," she said. "It's got to be robust, but zero tolerance is probably one step too close to the edge. We probably want something one step back from that. It is a bit of a balancing act."

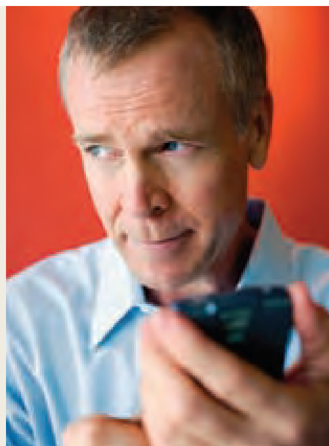
"Obviously the key to all of this is to get the early attention on problems in your company, to get it elevated to the highest level and remediate it as quickly as possible," said Chubb's Mr. Galban.

"We're watching it very closely," said Dan Riordan, president of Zurich Financial Services Group's North America commercial specialty unit in New York.

"It's just one element of a fairly broad act," Mr. Riordan said. "All underwriters are studying it and trying to understand the implications of it. We think its part of a broader set of heightened regulation and scrutiny from investors. I would expect our underwriters to be focused on it."

WHISTLE-BLOWER RULE

Highlights of the Securities and Exchange Commission's final whistle-blower rule



- Whistle-blowers who voluntarily provide the SEC with original information that leads to the successful enforcement by the SEC of a federal court or administrative action in which the SEC obtains at least $1 million in monetary sanctions could be entitled to 10% to 30% of the award.
- Whistle-blowers are encouraged, but not required, to first report alleged violations to a company's internal compliance reporting system.
- Certain people, including those with a pre-existing legal or contractual duty to report their information to the SEC, cannot collect the awards.
- It is unlawful for anyone to interfere with a whistle-blower's efforts to communicate with the SEC, including threatening to enforce a confidentiality agreement.
- The rule takes effect Aug. 12.

Source: Securities and Exchange Commission

Provisions: Dodd-Frank pay rules raise questions

CONTINUED FROM PAGE 6

insurance with Chubb Group of Insurance Cos. in Warren, N.J. He said clawback was the only provision other than the whistle-blower section "that's gotten a lot of attention" in the insurance world.

"This goes further than Sarbanes-Oxley," said Dan Riordan, president-Zurich Financial Services Group's North America commercial specialties unit in New York. It goes after "all incentive-based income to include all directors and former executives," he said.

One of the big questions is to "see how the clawback is going to work," said Ann Longmore, executive vp of Willis North America in New York. "The company is in the hot seat. What if the company doesn't claw back?" she said, adding that "timing is always an issue with the clawback." She asked: Does the clawback occur early in the case, or after a final adjudication or after a formal admission?

But other provisions in the law also will affect corporate directors and officers, said Ms. Longmore.

"Clearly" provisions that relate to executive compensation, required reporting and required shareholder votes can also be of concern, she said.

For example, Dodd-Frank requires companies to allow shareholders to participate in an advisory vote on executive compensation, said Marsh's Mr. Sheehan.

In some cases, the pay advisory vote has gone against management, said Kevin LaCroix, executive vp at OakBridge Insurance Services L.L.C., a division of R-T Specialty L.L.C. in Beachwood, Ohio. He said some companies already have modified compensation practices.

"We are at a time of major shift as to who's really calling the shots at the organization," said Willis' Ms. Longmore.

One D&O expert said Dodd-Frank should not have a great impact on corporations in expanded liability. Dan A. Bailey, member of Bailey Cavalieri L.L.C. in Columbus, Ohio, said: "I'm viewing Dodd-Frank like Sarbanes-Oxley; it will have very significant impact on how companies operate."

questions & answers

Richard Hildreth, managing director at Kroll Risk & Compliance Solutions in Reston, Va., a unit of Altegrity Inc., has plenty of experience handling kidnapping and extortion cases. He spent 29 years with the FBI and in 1998 joined Corporate Risk International, which Altegrity acquired last year. At Kroll, which Altegrity also bought last year from Marsh & McLennan Cos. Inc., his responsibilities include managing kidnap and ransom situations, which means he's in charge of arranging negotiations and making sure victims are released unharmed. He spoke with Business Insurance Senior Editor Michael Bradford about how that is accomplished.

Securing hostages' release a matter of negotiation

Q: How do kidnap and ransom negotiations generally begin?

A client will call us and say, "We have an incident." We have a 24/7 hotline, and these things never happen from 9 a.m. to 5 p.m. Monday through Friday. I ask the who, what, where and why questions.

Q: What are the first steps to address a kidnapping?

I manage these cases from our headquarters utilizing trained law enforcement or trained negotiators. We first identify a negotiator, and I direct the operations with the (employer) and our response team members. We've responded to cases all over the world.

Q: How do the negotiations take shape?

Negotiations with kidnappers could be for monetary or political demands. If we can talk to them about money, there is a good chance we'll be successful because they want their money. If the kidnapping is for political reasons, it becomes much more difficult. Negotiations can take anywhere from two days to two months or longer.

Q: How can you ensure the victim is not harmed?

We won't start a negotiation until we have proof of life, usually by actually speaking with the victim. We will ask them questions only the victim knows or the kidnappers will send us videos, maybe with the person holding the newspaper of the day as proof that the victim is alive.

Q: What is the procedure for making a payment to kidnappers?

The money is raised by the family of the victim or the company. We agree on a delivery strategy that is safe for our team as well as the victim. It's at a designated spot. If it's a U.S. citizen or a European that's kidnapped, the ransom is usually higher. That can change, too, if they are known to be wealthy. Ransoms can be anywhere from $200,000 to over $1 million. There are always exceptions; there was one that was $5 million, but usually if they are that high, there are multiple victims.

Q: What are the skills needed to be a successful negotiator?

Most of (our team members) have a great deal of experience in law enforcement. We train them to look closely at the cultural situations in different countries. Most have received hostage training and have experience in the do's and don'ts. It's hard to define how to do these things. Once it occurs, as much as we would like to be in control, as long as the kidnappers have the hostage, they are pretty much in control.

Q: How often do you negotiate kidnappings?

We handle 20 to 25 cases a year.

KIDNAPPING & RANSOM COVER

Companies expanding to areas where kidnapping is a risk are advised to have in place insurance that provides help with crisis management and coverage of ransom and other costs related to a kidnapping. Market sources say risk managers should be aware of the characteristics of such coverage, which is available from about a dozen insurers. K&R insurance typically includes:

- A relationship with a security consultant that can help develop a crisis management plan and handle negotiations with kidnappers, delivery of ransom and other tasks.
- Pricing that generally is reasonable and varies according to the type of business, number of locations and countries involved. Limits of $30 million can cost from $50,000 to $100,000, depending on where the risk is located and other factors.
- Coverage for the ransom amount, although typically it is a reimbursement. Insurers generally do not supply the funds. If a loan is used to pay a ransom, interest on the loan is covered.
- Payment of personal expenses incurred by a kidnapping victim while in captivity. For example, penalties for missing a personal loan payment.
- Access to information services such as travel security websites and regular updates on security conditions around the world.

Source: Insurers, brokers, security experts

Kidnap: Employees put at risk

CONTINUED FROM PAGE 4

the risk and expense, he said. "The amount of revenue needed to deal with security may not be worth it. It's a business decision."

Make sure the consulting service that comes with the K&R coverage is appropriate, Ms. Chaskin said. "If you go with an insurance company whose affiliated consultant is in South America but the bulk of your operations are in Asia, you haven't really addressed your risk," she said.

Kidnap and ransom insurance is available from about a dozen insurers, said Mr. Guillet. "The largest single capacity I've seen is $65 million. It's priced very reasonably," he said.

Insurance will cover the amount of a ransom payment, Ms. Chaskin said. Policyholders should include the mechanics of making such a payment in their crisis management plans, she said (see box).

"How will you get millions in cash, transport it and hand it over?" Ms. Chaskin asked. "If you know, you can put it into your crisis management plan."

Someone in the company's finance department should be a member of the crisis management team that responds to a ransom demand, Mr. Guillet said. "You need someone who knows where to go to get the cash. While a policy reimburses the customer for the ransom, it generally doesn't fund it."

In some parts of the world, kidnapping has decreased or other types of crimes against business executives are more of a problem, experts say.

"Colombia is one example," said Noel Paul, an attorney in Chicago with Reed Smith. "It was the poster child of kidnapping. It reached an apex in 2000, but after that the numbers began to drop."

Some credit for the reduction in kidnappings goes to the Colombian government, which stepped up efforts with U.S. help to clamp down on crimes such as kidnapping and drug trafficking in the country, Mr. Paul said.

"In China, we don't see a problem with kidnapping," said Kroll's Mr. Hildreth. "There is a very large military law enforcement presence, so there's not a lot of kidnapping."

Extortion and data theft are bigger problems in China, said Mr. Hildreth and other experts.

"If you're going to China with a laptop, all of that information is very vulnerable," Mr. Hildreth said.

Extortion also is more prevalent than kidnapping in Russia, experts said. Threats to damage property or harm employees unless a payment is made are more of a danger than an executive being held for ransom, he said.

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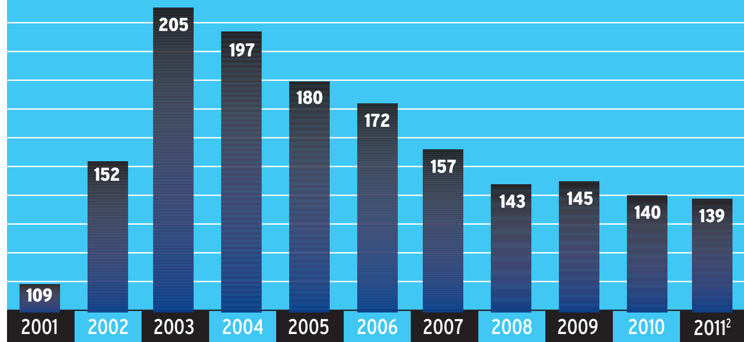
Tracking premium trends

Advisen Ltd., a New York-based insurance-related data and service provider, has been tracking commercial insurance pricing changes since 2000 in its proprietary Premium Index.[1] Below are ADVx changes in pricing for large-account directors and officers risks, middle-market agent and brokers professional liability, architects and engineers professional liability, and employment practices liability.

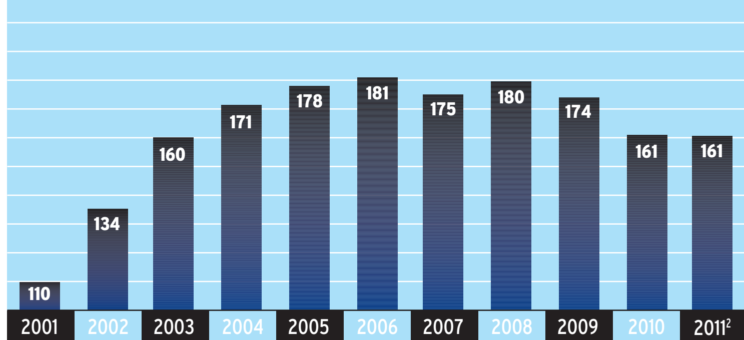
LARGE-ACCOUNT D&O

Directors and officers liability insurance premiums for large commercial accounts, which peaked in 2003, have declined since late 2009. Average premiums paid at renewal at year-end were:



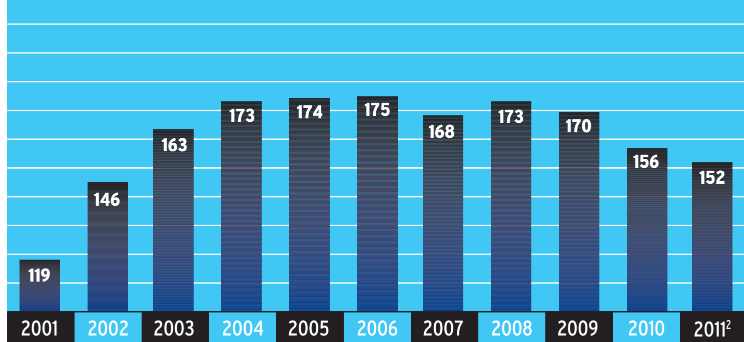
AGENTS & BROKERS E&O

Insurance agents and brokers professional liability premiums for middle-market accounts hit their highest levels in 2006 and 2008. They have moved in a narrow range the past year. Average premiums paid at renewal at year-end were:



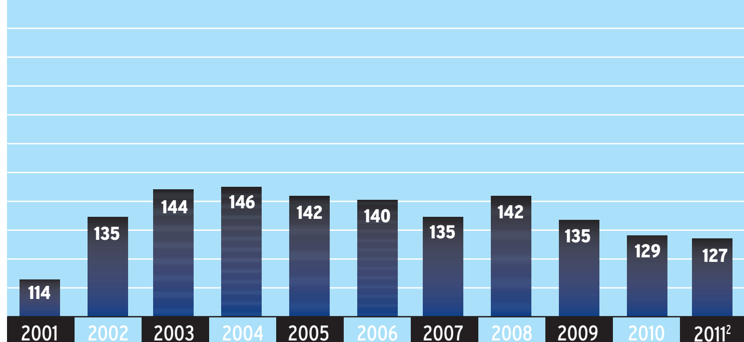
ARCHITECTS & ENGINEERS

Architects and engineers professional liability premiums for middle-market accounts rose steadily through 2006, but have declined somewhat since then. Average premiums paid at renewal at year-end were:



EMPLOYMENT PRACTICES

Employment practices liability premiums for middle-market accounts have hovered in a narrow range for several years. Average premiums paid at renewal at year-end were:



1 Advisen Ltd. weights components by relative premium volume as reported by A.M. Best Co. Inc.'s Best Aggregates & Averages, using Advisen-compiled data from retail and wholesale brokers and risk managers. Premiums adjusted to 2000 dollar value. 2000 is the benchmark of 100. 2 Through first quarter.

News In Brief

Transatlantic to merge with Allied World

Transatlantic Holdings Inc., the former reinsurance affiliate of American International Group Inc., is merging with specialty insurer and reinsurer Allied World Assurance Co. Holding A.G. in a $3.2 billion stock-swap deal, the companies announced. Both will operate as separate brands—Transatlantic Reinsurance and Allied World Insurance—under holding company TransAllied Group Holdings A.G. Longtime Transatlantic leader Robert Orlich will retire as president and CEO when the transaction closes, which is expected in the fourth quarter. In objecting to the deal, Davis Selected Advisers L.P., which owns a nearly 24% stake in Transatlantic, filed a statement with the Securities and Exchange Commission expressing "serious concerns about the proposed transaction."

Aon alleges employee, client poaching by Alliant

Two Aon Corp. units have sued several former executives and their new employer, Alliant Insurance Services Inc., alleging breach of contract, conspiracy and other charges in what Aon calls a "mass defection" of Aon employees and clients. In a Cook County, Ill., chancery suit, Aon Risk Services Cos. Inc. and Aon Risk Insurance Services West Inc. alleged that the former executives violated their employment agreements with Aon. The group includes Peter Arkley, who resigned as chairman and CEO of Aon's construction services group to head Alliant's construction practice. Aon holds that the former executives conspired with Alliant to solicit at least 40 other employees of Aon's construction services group to quit Aon and join Alliant, using "confidential and proprietary employee information such as Aon salaries, benefits and other employee information." An Alliant spokeswoman declined comment.

Commercial rates flat except comp: Analysis

Commercial insurance prices remained "relatively flat" overall during the first quarter of 2011, but workers compensation prices showed a modest increase, according to a Towers Watson & Co. survey. The first-quarter rise of about 2% in workers comp pricing comes after two years of relatively flat conditions, Towers Watson said. Workers comp prices already had been increasing in California, but were offset by decreases elsewhere during recent quarters. But prices outside of California showed an increase during the first quarter of 2011, the first time in nearly six years.

Dems question validity of McKinsey survey

Congressional Democrats are questioning the validity of a McKinsey & Co. survey that showed 30% of employers may drop their health care plans after 2014, when key provisions of the health care reform law go into effect. "The findings of this survey are so markedly out of sync with other assessments that it has raised legitimate questions about the product, including how and why it was created," nine House Democrats, including Reps. Henry Waxman, D-Calif., ranking member of the Energy and Commerce Committee, and Sander Levin, D-Mich., ranking member of the House Ways and Means Committee, wrote in a letter to McKinsey Managing Director Dominic Barton. The survey of more than 1,300 employers of varying sizes found that 30% "definitely" or "probably" will stop offering coverage after 2014.

Insurers join proposed drywall case settlement

A preliminary settlement was reached between Florida-based drywall suppliers, insurers and a proposed class of homeowners whose residences were damaged by tainted Chinese drywall, attorneys said. Banner Supply Co., a distributor of the tainted wallboard imported from China, entered a proposed preliminary settlement in New Orleans federal court that would pay approximately $55 million to affected homeowners in Florida. Banner's four insurers—Chartis Inc., FCCI Insurance Co., Hannover American Insurance Co. and Maryland Casualty Co.—have agreed to pay out the proposed settlement, according to court documents. Banner and several subsidiaries—Banner Supply Co. Fort Myers L.L.C., Banner Supply Co. Pompano L.L.C., Banner Supply Co. Tampa L.L.C., Banner Supply Co. Port St. Lucie L.L.C. and Banner Supply International L.L.C.—submitted the settlement to U.S. District Court Judge Eldon E. Fallon for approval.

'Mini-med' plan waiver application deadline set

Federal regulators say they will stop accepting applications after Sept. 22 from sponsors of limited health care or "mini-med" plans for waivers from a health reform law requirement that plans must offer minimum dollar coverage amounts for essential benefits each year. In addition, plan sponsors that already have received waivers—including those whose waivers have not yet expired—have until Sept. 22 to seek an extension, the Department of Health and Human Services announced Friday. The waivers now will last through the end of 2013 if sponsors comply with certain requirements.

N.Z. quake causes up to $5B in damage

Another powerful earthquake occurred near Christchurch, New Zealand, causing billions of dollars of insured damage in an area already reeling from a string of devastating quakes in the past nine months. EQECAT Inc. estimated the insured damage from the June 13 magnitude 6 earthquake at $3 billion to $5 billion. The quake's recorded epicenter was 6 miles southeast of Christchurch's central business district, where about one-third of the buildings were destroyed in a magnitude 6.1 earthquake that occurred Feb. 21.

Health savings account enrollment surges 14%

Enrollment in health savings accounts linked to high-deductible health insurance plans surged 14% to 11.4 million as of Jan. 1, according to an annual census. HSA enrollment rose in the large-group and individual markets, but fell slightly in the small-group market, according to the survey by America's Health Insurance Plans. The large-employer market registered the largest percentage gain over the previous year. Employers with at least 51 employees had 6.3 million people in HSA-linked plans at the start of the year, a 26% increase in the past year. In the individual market, enrollment climbed to nearly 2.4 million, an increase of 15%. However, HSA enrollment in the small-employer market dipped to 2.8 million, a drop of nearly 7%.

Aon, firms partner to cover infestations

Aon Risk Solutions, Global Excess Partners L.L.C. and Terminix International Co. L.P. have formed a strategic alliance to provide hotels, landlords, student housing and corporate businesses with a suite of products addressing bedbug infestations. The insurance combines pest management coverage for bedbugs with pest elimination resources provided by Terminix. Global Excess Partners, which has binding authority over six Lloyd's of London syndicates, provides the coverage. It includes bedbug elimination costs, bedbug management services and lost revenue resulting from out-of-service rooms.

Noted

Peter R. Porrino has been appointed executive vp and chief financial officer of **XL Group P.L.C.** Mr. Porrino is the global insurance industry leader at Ernst & Young Global Ltd. in New York. Effective in late August, Mr. Porrino will succeed Irene M. Esteves, who was named executive vp and chief financial officer at Time Warner Cable Inc. Mr. Porrino will be based in the U.S. Northeast....**Everest Re Group Ltd.** has named Dominic J. Addesso as president and John Doucette as chief underwriting officer for worldwide reinsurance. Both will be based in Hamilton, Bermuda....J. Eric Smith will join **Swiss Re Ltd.** as president and CEO of its Americas division effective July 11. He will succeed Pierre Ozendo, who plans to retire this year and join the board of Swiss Re America Holding Corp. as a nonexecutive director.

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REINSURANCE BROKERS: Companies that work directly with ceding companies to place reinsurance and provide related services.

PROPERTY/CASUALTY INSURERS: Companies that provide commercial lines property/casualty insurance on an admitted or non-admitted basis.

GROUP LIFE/HEALTH INSURERS: Companies that provide group health insurance, managed care companies and companies that provide group life insurance.

CLAIMS MANAGERS: Companies that handle commercial insurance claims for self-insured clients on a direct, unbundled basis; or companies that offer case management services directly to members of employer-sponsored group plans.

GROUP HEALTH ADVISORS: Companies that engage in group health plan consulting, design, administration or procurement.

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