

SPECIAL REPORT

DIRECTORS & OFFICERS LIABILITY COVERAGE

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The purpose of this report is to review directors and officers liability coverage.

Directors and Officers Liability

Directors and Officers Liability Insurance provides financial protection for the directors and officers of the company in the event they are sued in conjunction with the performance of their duties as they relate to the company.

D&O policies can also cover the business entity if the policy is specifically endorsed to include entity coverage. Since lawsuits brought by stockholders, employees, and clients may be made against the company, AND against the directors of that company, the entity should also be covered.

Directors and Officers Liability Insurance (“D&O”) is insurance purchased by the company and is payable to the directors and officers of that company to cover damages they personally incur defending and/or paying damages for covered lawsuits. These types of lawsuits are typically brought by shareholders, shareholder-derivative actions, customers, regulators, and competitors (for anti-trust or unfair trade practice allegations).

One of the main purposes of maintaining D&O coverage is that it assists the company in attracting and retaining officer and directors. Since a director can be held personally responsible for acts of the company, most directors and officers will demand to be protected rather than put their personal assets at stake. Investors and members of the company board of

directors may not be willing to risk their personal assets to serve as a corporate director or officer, no matter how closely they may be related to your company.

Investors, especially venture capitalists, usually require that a company show evidence of Directors & Officers Liability insurance as part of the conditions of funding that company.

D&O lawsuits come in many different forms. (Employment practices constitute the single largest area of claim activity under D&O policies with over 50% of D&O claims originating under employment practices disputes; however, these claims are covered under a separate employment practices policy.)

The following illustrate other common areas of D&O claims:

- Acquiescence in conduct of fellow directors engaged in improper self-dealing.
- Approval of corporate acquisition with resulting loss of corporate assets.
- Causing the corporation to incur unnecessary tax liabilities.
- Civil liabilities in connection with prospectuses and communications.
- Compensation arrangements.
- Competition with corporation.
- Conflicts of interest.
- Continual absence from meetings.
- Corporate debts and delinquencies.
- Corporate gifts or contributions.
- Declaration of dividends.
- Failure to purchase insurance.
- Ignorance of corporate books and records.
- Improper repurchase of stock.
- Inadequate dividend payments.
- Inadequate investigation of facts included in public filings.
- Inefficient administration resulting in losses.
- Loans by corporations.
- Loans from to and/or from officers, directors, or stockholders.
- Misuse of insider information.
- Neglect of proper management with respect to corporate debts and delinquencies.

- Transactions between corporations having common directors.
- Transactions with other companies in which officers or directors are personally interested.
- Unfair competition.
- Violations of specific provisions of articles or by-laws.
- Wasting of corporate assets.

D&O lawsuits are often costly. The average total cost to the company of a D&O event, including judgments, settlements, fines, and legal fees is \$697,902!

D&O lawsuits are almost as common for private companies as public companies. In the past decade, D&O claims affected:

Public Companies	33%
Private Companies	27%

13% of those surveyed by Chubb experienced a D&O-related event in the past 3 years.

28% of private companies purchase D&O liability insurance.

Listed below are types of D&O claims brought against private companies in the past 10 years:

- 38% Employment-related
- 25% Derivative Shareholder/Investor Suit
- 19% Director Shareholder/Investor Suit
- 19% Regulatory
- 19% Fiduciary
- 25% Other

Losses reported were from vendors, competitors, investors, shareholders, employees, government, and regulatory agencies.

D&O policies have terms and conditions just like all insurance policies and not every claim is fully covered; however, in a multiple count lawsuit. If one count is covered, the insurance carrier may be obligated to pay defense costs for all counts.

This may be an important safety net for business owners faced with significant legal fees in a lawsuit that may not be covered by other business policies.

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