Insurance Buyers' News

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Understanding Your D&O Coverage

What keeps directors up at night? Many worry about personal liability from their board service. In a 2011 survey, 76 percent of CEOs surveyed said they were not confident for-profit boards had adequate insurance coverage, and 70 percent said the same about nonprofit boards. Only 59 percent of respondents said their board had directors and officers (D&O) liability coverage. *(Source: Survey, Chartis and The Chief Executive Group)*

D&O policies will pay legal defense costs and settlements for directors' and officers' personal liability for actual or alleged "wrongful acts" committed in the course of their official duties. Policy definitions vary, but "wrongful acts" usually include actual or alleged acts, errors, omissions, neglect or breaches of duty, misstatements or misleading statements.

Even if you have D&O coverage, does it fully protect your directors and officers? Understanding your risk exposures and what your policy covers can help you avoid potentially costly coverage gaps. Some things to look for include:

- Exclusions. Typically, policies exclude: **1**) claims for bodily injury, property damage and personal injury, such as libel, slander and emotional dis-

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This Just In

Fewer than half of business owners feel confident about their personal finances, found a study by MassMutual. The study found these specific problem areas:

- **More than a quarter (28 percent) of business owners say they have enough to do to keep up with everyday business expenses, let alone plan for the future.**
- **Only 40 percent of business owners realize the importance of knowing their business' current value, and only 57 percent have had their business valued in the past three years.**
- **Business owners ranked keeping key employees loyal as their top concern, voiced by 53 percent. But fewer than one-third have special benefits for key employees or "key person" insurance to protect the business against the**

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tress. Your general liability policy covers these risks, **2**) "prior incidents" and "prior litigation," or incidents reported in earlier coverage periods and litigation begun before the policy period, **3**) ERISA liability, which results from administering pension and welfare plans, **4**) pollution or environmental impairment liability, and **5**) coverage for punitive damages.

Other exclusions vary more. For example, some policies specifically exclude securities actions; some exclude coverage for fraudulent, dishonest or criminal acts. Publicly traded firms buy D&O coverage, in part, to protect directors and officers from these types of claims. If your policy contains these exclusions, you will want to negotiate with your insurer to have them removed.

- Coverage for regulatory actions. D&O policies can cover costs if a regulatory agency investigates the organization for some wrongdoing. However, some policies exclude coverage for specific activities, particularly in the financial services field. And some policies might specify coverage for regulatory activities by named agencies. This could imply the policy limits coverage to actions by named agencies only, warned attorney and D&O blogger Joseph Monteleone of Tressler LLP in New York.
- "Preclaim" costs. D&O policies traditionally do not cover costs an organization incurs when investigated as a "party of interest" or in an informal inquiry, as opposed to when it is the target of an investigation. Some insurers now offer coverage for pre-claim costs in certain situations, reports *Business Insurance* magazine (8/7/11).
- Securities suits brought outside the U.S. Will your policy cover investigation and defense costs incurred in a foreign jurisdiction, as well as any potential settlements? This coverage could prove important to multinational firms, as other countries beef up their securities regulation.
- Advancement of loss. Whether a policy actually covers a claim can remain undecided until the case is resolved. For example, many claims against directors and officers allege fraud, which many policies exclude. Meanwhile, defense and investigation costs accrue. If your insurer reimburses insureds for legal defense costs before settlement, it might stipulate that the insured reimburse the insurer if the claim turns out to be uncovered.
- Severability. Wrongful acts can void coverage, so you will want your policy to have a severability clause, which clearly states that the wrongful act of one director or officer will not be imputed to any other director or officer.
- Entity vs. insured exclusion. Older D&O policies often have an "insured vs. insured" exclusion, which excludes coverage for claims brought by one insured against another. This could include suits brought by the corporation against insured directors and officers (or ex-directors and officers), if your policy covers the corporate entity. The newer wording specifically eliminates coverage for suits by the corporate entity against its own officers and directors.

This Just In

loss of one of these valued employees by death or disability.

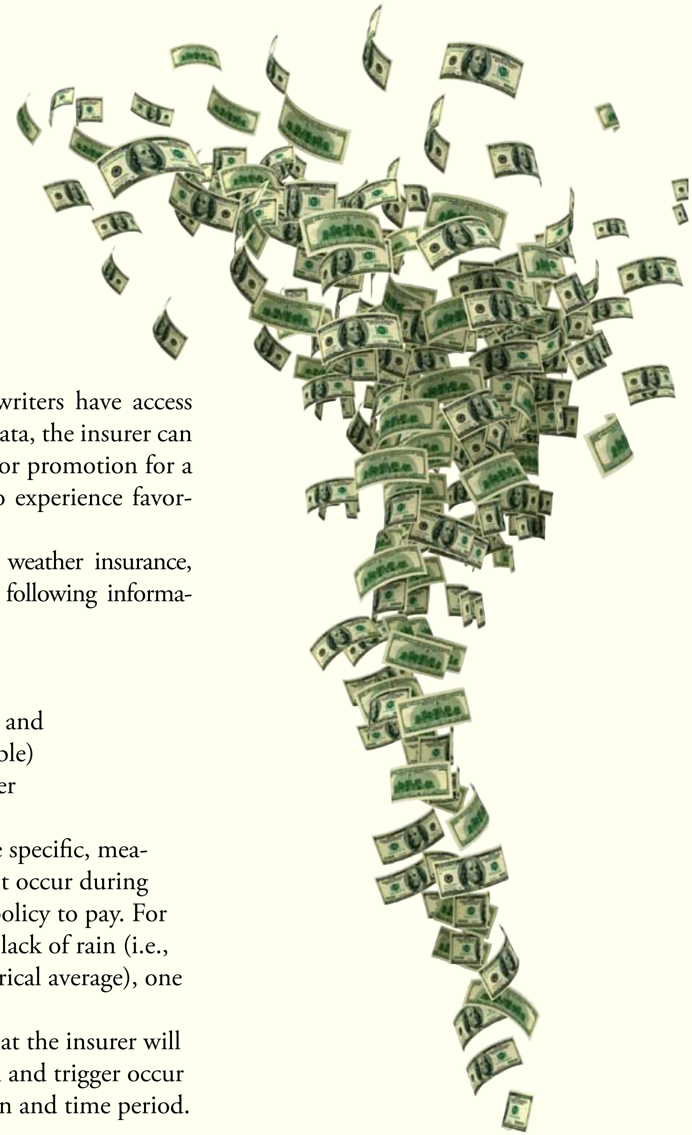
- **Only a third have formal retirement income strategies, and fewer than half are confident they are financially well prepared for retirement.**
- **Only 26 percent of business owners have a formal succession plan in place. That leaves the remaining three-quarters of small businesses in jeopardy in the event of the owner's sudden death or serious health problem.**

A sound business plan accounts for the owner's secure retirement and orderly succession. An experienced agent can help you with your personal and business financial planning.

- Coverage for bankruptcies. Chapter 11 filings often trigger shareholder suits against the corporation's directors for breach of duty or fraud. When a company goes into receivership, ownership of the D&0 policy and its proceeds can come into question. Entity coverage under the policy can also reduce the limits available to defend directors and officers. Policies can be amended to fix these coverage gaps.

The complexity of claims against directors and officers makes D&O one of the most challenging areas of coverage. Every corporation's situation and policy needs individual analysis. We can help you evaluate your risk exposures and coverage needs. Please contact us for more information.

Weathering the Storm with Weather Insurance



It's a truism that people always talk about the weather but never do anything about it. If weather-related hazards pose a significant risk to your organization, you can buy insurance to protect it from financial loss.

Businesses that use weather insurance include farms, special event promoters, filmmakers, contractors and retailers. Weather insurance policies can protect your organization from any type of weather — too much or too little rain, excess heat or cold, wind speed, photographic conditions, tides — that affects your business. Weather insurance might also fill an important gap in your business insurance program. Most standard business policies do not cover business interruption due to weather. You can often tailor a weather insurance policy to cover weather-related loss of earnings, repairs or cleanup.

Weather insurance coverage usually costs from 1 to 10 percent of the amount at risk, depending on the weather perils, location and type of risk. Policyholders can select the benefit trigger to reduce costs — for example, the promoter of an outdoor music festival may opt for a policy that provides coverage if more than ¼" of rain falls only on the festival's weekend days. In addition, since weather insurance underwriters have access to sophisticated weather data, the insurer can help you plan your event or promotion for a time you're most likely to experience favorable weather.

To obtain a quote for weather insurance, you'll need to provide the following information:

- Named insured
- Location of risk
- Covered date or dates, and time of day (if applicable)
- Peril, or type of weather to be insured against
- Weather trigger, or the specific, measurable event that must occur during covered dates for the policy to pay. For example, ½ inch rain, lack of rain (i.e., less than 80% of historical average), one foot of snow.
- Payout amount, or what the insurer will pay if the insured peril and trigger occur at the specified location and time period.

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Weather insurers will either use on-site monitoring or data from a local weather station, usually specified in the contract, to verify the insured event occurs.

For more information on the uses of weather insurance, please contact our office.

In addition to covering special events, weather insurance has many other uses:

- To supplement federal crop insurance. The federal crop insurance program typically does not pay until a farmer experiences very large yield losses. Weather insurance cover the smaller losses left uncovered by the federal program, but that can make the difference between profitability and loss. It can also cover crops ineligible for the federal program.

  Getting a claim paid under a weather insurance program is also simpler. Crop policies typically require the insured to notify his/her agent within 72 hours of discovery of crop damage. The insurer inspect the crop and estimate losses; you cannot plow, disk, replant or otherwise damage evidence until the adjuster gives permission. The policy will pay based on your estimated loss.

  Weather policies require no inspection or estimates. They pay if a specified weather event occurs during a specified time period. For example, an orchardist might insure against freezing weather while blossoms are setting. If weather dips below the specified temperature during the specified period will pay the agreed amount. No inspection or estimate of damage needed.
- To cover filming costs. Filmmaking often requires large crews and casts. If weather is not suitable for filming on scheduled days.
- To cover lost sales. For example, a ski resort has fixed expenses during the season, whether the slopes are crowded or not. Unusually warm or wet weather during a key holiday week means fewer people buying lift tickets, rental packages, lessons and meals. Weather insurance can mean the difference between profitability and loss.
- To cover weather-related promotions. A jeweler might promote engagement rings by offering to pay for the ring if it rains on your wedding day. Weather insurance can offset losses from such promotions.
- To cover snow removal costs. Weather insurance can help offset extra expenses due to an unusually snowy season. A weather risk derivatives market also exists, which allows organizations with weather-related risks to enter into contracts with investors willing to take on those risks. Originally used by energy companies to cushion the effects of weather-related fluctuations in demand, weather contracts now represent a $12 billion market annually. Other types of industries now use weather contracts, including contractors and manufacturers. The Chicago Mercantile Exchange now trades contracts related to temperatures, snowfall, frost and hurricanes. Specialized brokers can help businesses place these contracts. For more information, please call us.

Better Coverage for Improvements and Betterments

If you rent your business premises, you may need to make improvements and betterments to the property. These improvements — such as interior walls, carpeting and fixtures — automatically become the landlord's property.

Even when you install improvements at your own expense, chances are your lease requires you to protect the landlord's "ownership interest" in them by buying replacement cost coverage insurance. Although commercial property policies cover improvements and betterments, most will only cover your "use interest" in them. This means that in a claim, your policy would pay the unamortized portion of the original cost of the improvements. For example, if you invested $20,000 in improvements at the beginning of a 10-year lease, and your building were destroyed at the end of the second year, you've lost 80 percent of your investment. In this case, the policy would pay you $16,000 (minus any deductibles), regardless of how much it would cost to replace the improvements. You would be liable to the landlord for the remainder.

Depending on the rental market in your area, you may be able to negotiate with the

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landlord to have him/her agree to insure improvements and betterments. The landlord can do this in the lease or by separate written agreement with the tenant. Using a mutual waiver of subrogation is also recommended. This means both the landlord and the tenant waive their right to recover damages from the other party, even if the other party may be responsible for those damages.

A waiver of subrogation will not impair insurance recovery.

If the landlord assumes the responsibility of insuring the improvements, make sure that the lease also requires the landlord to repair or replace improvements (along with the building) if they are damaged or destroyed.

If you can't negotiate your lease wording, you may want to buy leasehold interest insurance. Although designed primarily to protect tenants from losses suffered due to the cancellation of a favorable lease because of insured loss or damage to the building, it also covers your improvements and betterments.

For more information on protecting your investment in improvements and betterments, please call our office.

Improvements vs. Trade Fixtures

The standard commercial property policy defines improvements and betterments as "…fixtures, alterations, installations or additions: (a) Made a part of the building you occupy but do not own; and (b) You acquired or made at your expense but cannot legally remove." According to *Black's Law Dictionary*, an improvement is a "valuable addition made to property (usually real estate)…amounting to more than mere repairs or replacement, costing labor or capital, and intended to enhance its value, beauty or utility or to adapt it for new or further purposes."

Trade fixtures are "personal property used by tenants in carrying on business. Such fixtures retain the character of personal property; e.g. shelves used to display merchandise." Although trade fixtures may be relatively permanent structures, such as counters or heavy equipment, they differ from improvements and betterments in that tenants can remove them when they leave the leased premises.

D&O Basics

Wealth and high community profiles make executives more vulnerable to lawsuits than other individuals. Typical claims against directors and officers include employment-related liability, such as discrimination, harassment and wrongful termination; mismanagement of assets; and failure to provide services.

State law or your corporate bylaws might require corporations to "indemnify," or reimburse, directors and officers for personal liability that arises from their official duties. You do not need to buy insurance for this risk, but buying a directors and officers liability (D&O) policy can ensure you have the funds needed to cover these often costly claims. And lack of adequate insurance coverage can discourage executives from wanting to serve on your board—whether it's a for-profit or non-profit entity.

As nonstandard policies, D&O policies can vary greatly from insurer to insurer. The typical D&O policy contains two parts:

- Part A covers directors and officers, reimbursing them directly for claims of liability that arise from their corporate duties.
- Part B covers the corporation, reimbursing it for expenses it pays on behalf of the directors and officers, if state law permits or corporate charter or bylaws require the corporation to indemnify directors and officers.

Some policies also contain Part C, or "entity coverage," which covers the corporation itself when it is named in a lawsuit or claim. Insurers began adding entity coverage to their D&O policies in the 1990s, in response to a spate of securities and employment practices liability lawsuits that named the corporation as a defendant along with the directors and officers.

Please see the article on P. 1 for suggestions on what to look for in a D&O policy. ■

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