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ProNetwork News

Risk Management Tools for the Design Professional

info@aepronet.org | www.aepronet.org

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Ryan Apgar, RPLU

SVP / Principal
Socius Insurance Services
Phone: (415) 796-0615
rapgar@sociusinsurance.com

Kirk Denebeim

SVP / Principal
Socius Insurance Services
Phone: (415) 796-0616
kdenebeim@sociusinsurance.com

a/e ProNet
Dave Johnston, Executive Director
info@aepronet.org

Why Private, For-profit Companies Should Purchase Directors, Officers & Company Liability Insurance

By Ryan Apgar, RPLU and Kirk Denebeim

It is a fact of doing business in the United States: Lawsuits happen. Regardless of whether the action has any merit, lawsuits are expensive to deal with, damaging to reputations and draining to a business and its executive team. Small to mid-sized private companies, including design firms, can specifically attest—litigation is never a small or inconsequential matter. Any business, regardless of the sector they are in (i.e., design, construction, manufacturing, etc.), can find itself embroiled in a dispute.

Directors, Officers & Company ("D&O") Liability Insurance, for privately-held companies can be a lifesaver in the event an unexpected lawsuit or dispute arises. When a business and its management team are placed in an adversary's crosshairs, when coverage applies, a D&O policy would step in to respond right off the bat. This response would include providing a defense, including the engagement of skilled legal counsel who will guide the D&Os through the process. In addition, when coverage applies, the D&O policy would fund the settlement of a lawsuit or pay a judgment if the case were to go to trial.

Originally, D&O coverage was designed to protect only the individual directors and officers from lawsuits brought by outside shareholders who are not involved in the management of the company. However, D&O products have evolved and expanded considerably over the past 20 years. A contemporary private company D&O policy can provide coverage for the entity, as well as the individual D&Os, against a wide range of allegations and claims, not only from shareholders, but also clients, competitors, vendors, creditors, and regulators.

Below are a few examples of typical D&O claim-initiators, as well as examples of situations from which D&O claims may arise:

Shareholders, Investors, Partners and Members:

- Mergers / Acquisitions
- Financial performance
- Executive compensation
- Stock or other offerings
- Conflicts of interest
- Bankruptcy
- Inadequate / Inaccurate disclosures
- Financial reporting

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How Effective is Your Risk Management Program?, by Tim Corbett. Many design firms attend risk management training sessions and implement certain practices based on an industry trend or project claim. Other firms may only concentrate on contracts and insurance coverage's as a risk management strategy, which only addresses a portion of an effective risk management program. Read More

GUEST ESSAYS

Mergers and Acquisitions and Successor's Liabilities - Many of today's mergers and acquisitions have a hidden "Russian roulette feature" which if unaddressed, could prove to be financially fatal years after a deal is completed. Mergers and acquisitions have played a major role in the business marketplace for many years. Many companies acquired other entities with little thought to the potential liabilities that they could inherit which is known as *successor liability*. Read More

Internal Risk Management. Whether you like it or not, the practice of Architecture or Professional Engineering is a business. Profit is the goal. Unfortunately, in the current business environment the Architect or Professional Engineer is confronted with increasing competition for fewer and fewer profitable projects. The claims-to-revenue ratio is already high and will likely become higher due to a weakening economy, which has caused many owners and contractors to experience financial difficulties. Read More

a/e ProNet
Dave Johnston, Executive Director

info@aepronet.org
www.aepronet.org

Customers, clients and consumer groups:

- Extension, refusal of credit
- Debt collection
- Deceptive trade practices
- Contract disputes
- Restraint of trade
- Dishonesty
- Cost, quality of product or service
- Lender liability

Other third-party claims against Directors and Officers (including competitors):

- Anti-trust
- IP Infringement
- Business interference
- Competitor disputes
- Prospective company acquisition
- Company defamation
- Tax issues
- Regulatory / other government issues

A disturbing fact for members serving on the company's Board of Directors is that D&Os can, and usually do, get personally named in a lawsuit asserted against the company. As defendants to a suit, the claim seeks personal liability against the D&Os to fund a judgment. The more closely held a company is, the fewer owners/D&Os there are to sue. Therefore, the exposure to the personal assets of those principals is even more pronounced. D&Os know that, in most states, a corporation is required to indemnify its D&Os for personal liability, if such liability arose from the execution of their corporate duties. If the corporation is on financially sound footing, the D&Os' personal assets, such as their homes, cars, furniture, kids' college tuition and savings accounts, will **usually** be protected via the Company.

However, situations often arise where the Company cannot or will not defend a D or O, compelling them to defend themselves. Such cases can exist when the Company is not on solid financial footing, when they become insolvent, or are prevented from defending D&Os by law. As troubling as it may sound, in tough financial times, or under unique statutory restrictions, the D&Os could unfortunately find themselves paying for their own defense and/or settlement of a lawsuit out of their own pockets.

When a lawsuit hits, the financial advantages of having D&O coverage are readily apparent. What isn't evident from reviewing policies is something we've witnessed over the course of watching many D&O claims unfold. When serious accusations of wrongdoing are leveled at a member(s) of management and there is no D&O coverage to fall back on to fund the claim, the financial burden of a dispute has been known to tear a management team apart.

For example, suppose you are the officer who is the target of certain allegations. How quickly do you think your colleagues will rally around you when your alleged error or omission is the cause of significant financial hardship to the company? Without D&O insurance in place to shoulder the financial and legal burden of a claim, infighting can erupt rather quickly when the Company's financial resources are placed in peril. When accusations fly, and salaries and bonuses might be affected, such situations often change the way people behave toward one another. As opposed to circling the wagons, executives may play the blame game.

In contrast, if D&O insurance is in place, there may not be such a panic, and finger pointing may not be as fierce or important. Accordingly, it is believed that one of the

great hidden benefits of D&O insurance is that it tends to diffuse internal turmoil and helps maintain management cohesiveness during what is surely a trying time. When D&O insurance is in place and coverage has been accepted, the management team is generally able to more easily maintain a “stick together” attitude and an “us against them” mentality. To summarize, we believe it is imperative for private companies to carry D&O insurance, both for the sake of the companies and their principals, regardless of industry. D&O coverage acts as a solid backstop to mitigate and/or solve what could be the devastating financial impact of unforeseen business litigation. Litigation can happen at any time from within or from outside any organization. In a society as litigious as ours, not having D&O insurance creates a serious exposure to the business itself, as well as every member of a company’s management team personally. Principals of design firms, no matter what size or specialization, should carefully consider the purchase of D&O insurance as a tool to help ensure that their practice, as well as their personal assets, are protected.

a/e ProNet
Dave Johnston, Executive Director

info@aepronet.org
www.aepronet.org