

Board Liability

Directors of Small, Mid-sized Firms Increasingly Sued

JURY AWARDS and settlements against directors and officers of companies have increased dramatically, largely due to federal securities class-action lawsuits.

But while small and mid-sized business owners often believe they won't be targeted by those kinds of lawsuits, directors and officers of privately held companies can also be sued, leaving their personal assets at risk.

Unfortunately, many small and mid-sized business owners, while insuring their firms, often overlook their directors' liability. This protection gap can be covered with directors and officers (D&O) liability insurance, which protects company leaders from litigious employees, competitors, investors, vendors — and even customers.

Directors and officers can be held personally liable for civil, criminal or regulatory proceedings should they fall short of their obligations, and their personal assets could all be at risk.

General liability or umbrella business insurance policies do not cover claims involving directors and officers.

For smaller firms, which typically have fewer resources to defend allegations or fund potential fines, penalties or awards for damages, D&O is becoming an increasingly important coverage.

One in eight owners of small businesses surveyed by Chubb Group reported having been sued in the previous five years. The average damage from the lawsuits was \$225,682 in losses. Some suits cost much more, with losses approaching \$5 million.

What D&O covers

One of the most important aspects of a D&O policy is that it's a protection against the costs of frivolous lawsuits.

D&O covers court costs and lawyers' fees if a business becomes the target of regulators, or even a criminal investigation. But the policy will not shield managers if they commit fraud or participate in crime.

That said, if one board member is convicted of fraud while the other board members are innocent, a policy could still cover the legal costs of those who did no wrong.

The typical action that would trigger a D&O policy would allege that management committed some wrongful acts.

COMMON CLAIMS FOR SMALL FIRMS

- Allowing misleading information in a company prospectus.
- Not complying with regulations and laws.
- Employee-driven lawsuits alleging management allowed harassment or discrimination despite knowing about it.
- Suits by investors about decisions concerning mergers and acquisitions.

DIFFERENT 'SIDES' OF D&O POLICIES

There are varying deductibles for the different "sides" of the policy.

Side A – Known as the "personal protection" part of the policy, this indemnifies directors and officers if the company is unable to do so.

Side B – This part reimburses a company if it pays the legal bills of its directors and officers due to an action against them in their company capacity. Side B responds most commonly in the majority of claims brought against directors and officers.

Side C – Known as "entity coverage," this part covers a company if it is sued alongside any directors and officers.

Sometimes it's best to mix and match coverages based on your organization-specific risks. For some companies, a Side A will do.

We can evaluate and review the coverages and policy language associated with D&O insurance for you to find a policy that best suits your organization and board.

Cost of coverage

There are a number of low-cost D&O policies available for small firms. The cost of providing a director with a \$1 million limit is more affordable than you may realize. Call us for details.

Sometimes you will have little choice but to purchase a policy. For example, many directors and officers may refuse to take on a position without the coverage. And if your business wants to attract new funding, most institutional investors require the protection. ❖

