Module 7

Management Liability Loss Exposures

Management Liability Loss Exposures and Insurance

Module 7
Chapter 7

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Objectives

- Obj I: Directors and Officers Liability Loss Exposures
- Obj II: Directors and Officers Liability Insurance
- Obj III: Specialty Directors and Officers (D&O) Coverages
- Obj IV: Employment Practices Liability Loss Exposures
- Obj V: Employment Practices Liability Insurance
- Obj VI: Fiduciary Liability Loss Exposures
- Obj VII: Fiduciary Liability Insurance

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Directors and Officers Liability Loss Exposures

Objective I

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Role of Directors and Officers

- A corporation is owned by its stockholders but controlled by its board of directors.
  - Directors are elected by its stockholders.
- Major responsibilities:
  - Establishing corporation's goals and policies.
  - Electing or appointing officers.
  - Approving important financial matters.
  - Fulfilling their fiduciary duties.
    - Breach of duty is common basis for claims.

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Duty of Care

- Directors have a duty of care (diligence).
  - Must act in good faith and in a manner they believe to be in corporation's best interests.
  - Must discharge their responsibilities with informed judgment and reasonable care.
- Courts have held that directors and officers are not guarantors of the enterprise's profitability.
- Directors have a duty to keep themselves informed of the facts required to make prudent business decisions.

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Duty of Loyalty

- Directors have a duty of loyalty to both the corporation and the shareholders.
  - Cannot own or operate businesses that compete with the corporation.
- Directors cannot use insider information to buy or sell stock of the corporation.
  - Must pay back to the company any profit realized from sale of stock within six months of purchase.

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Duty of Disclosure

- Directors must disclose material facts to all persons who have a right to know such facts.
  - Must refrain from discussing confidential or market-sensitive matters with others.
- Normally, directors are not authorized to act as spokespersons for the corporation.

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Duty of Obedience

- Directors must perform their duties according to federal and state law.
  - In addition, must obey terms of the corporate charter.

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Suits Against Directors

Description	Who Brings Suit?	Suit Brought on Behalf of?	Who Receives Damages?
Derivative	Shareholders	Corporation	Corporation
Nonderivative	Customers, employees, competitors, shareholders	Individual(s) bringing suit	Individual(s) bringing suit
Class Action	One or more individuals on behalf of group	Group	Group

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Indemnification of Directors

- Directors who have successfully defended against a derivative suit have the right to indemnification from the corporation.
  - Corporations often make payment to settle claims against their directors.
- State legislatures enacted statutes granting directors the right to indemnification.
  - Some of the statutes are "exclusive" in that they authorize indemnification only to the extent provided by the statute.

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Practice

- A lawsuit brought about by one or more shareholders in the name of the corporation, in which any damages awarded are paid directly to the corporation, is referred to as a:
  - A. Class action suit.
  - B. Derivative suit.
  - C. Nonderivative suit.
  - D. Fiduciary suit.

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Directors and Officers Liability Insurance

Objective II

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D&O Liability Insurance

- Directors and officers liability insurance covers losses from wrongful acts of directors.
  - Corporation usually purchases policy.
  - Individuals often refuse to serve on a board unless they are covered.
- ISO maintains a standard D&O form.
  - Many insurers use their own forms.

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Insuring Agreements

- Most policies have two insuring agreements.
  - Coverage (Side) A – insures directors and officers.
    - Indemnifies directors and officers.
  - Coverage (Side) B – insures corporation for the amounts it is required to pay to defend or settle claims against the directors or officers.
    - Indemnifies corporation.

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Insuring Agreements

- Coverage A is limited to losses for which the corporation does not or cannot provide indemnification to the directors or officers.
  - If corporation is lawfully able to indemnify the director, loss will be paid under Coverage B.
  - If corporation cannot indemnify the director, loss is payable to director under Coverage A.
- A D&O liability policy is ordinarily subject to an each loss limit of liability and an aggregate limit of liability.

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Insuring Agreements

- Many D&O policies also contain a Coverage C.
  - Entity coverage.
  - Makes the corporation itself an insured for claims made against it.
- Without entity coverage, a policy covers the corporation only for indemnification of directors.
  - Coverage B.

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Claim

- Almost all D&O policies are written on a claims-made basis.
  - Covers loss if claim is made during policy period, even if act occurred years prior.
  - Usually provides extended reporting period.
- Claims may include:
  - Demand for monetary or nonmonetary relief.
  - Civil proceeding commenced by a complaint.
  - Formal regulatory proceeding commenced by filing a notice of charges.

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Loss

- The term "loss" includes damages directors and officers become legally obligated to pay.
  - Subject to certain exclusions and limitations.
- Many D&O liability policies define loss to include defense costs.
  - Limits of liability apply to the sum of damages and defense costs combined.
- Loss typically excludes fines or penalties, punitive or exemplary damages, or the multiplied portion of any damages.

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Persons and Organizations Insured

- The insureds under Coverage A are the individual directors and officers.
  - Includes any persons who shall become duly elected or appointed.
  - In the event of the death, incapacity, or bankruptcy, coverage is usually provided for director's estate or legal representative.
- The entities insured for Coverage B are the insured corporation or corporations named in the declarations.

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Exclusions

- Typical D&O exclusions:
  - Loss exposures better covered by other insurance – bodily injury, property damage, personal injury, advertising injury.
  - Claims covered under prior policies.
  - Failure to effect or maintain insurance.
  - Insured vs. insured exclusion – one director sues another director.
  - Loss exposures difficult to insure – fraudulent acts that are uninsurable.

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Duty to Defend

- Under a D&O policy, the insured typically selects and pays the defense lawyers and pays the other defense expenses.
  - Insurer reimburses insured for costs.
  - Insurer's consent to incur expenses and settle claims is usually required.
- Most policies require the insurer to make payments for defense expenses as incurred.
  - Prevents insured from having to wait potentially many years for reimbursement.

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Consent to Settle Claims

- Some D&O policies contain an absolute consent-to-settle provision.
  - Insurer cannot settle a claim without the insured's consent.
- If the insured does not consent to a proposed settlement, the insurer must continue to defend.
  - Must pay any judgment awarded until the limit of its coverage has been exhausted.
- Hammer clause provides that the insured must take over the defense and pay further expenses.

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Deductibles and Coinsurance

- D&O liability insurance is almost always subject to a deductible, also called a retention.
  - Generally applies to both defense costs and judgments or settlements.
- Deductibles can vary substantially.
  - Coverage A deductible may apply separately to each individual.
  - Substantial deductibles often apply to Coverage B, with a small or no deductible applicable to Coverage A.

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Arbitration

- Recent D&O policy conditions include a binding arbitration provision for disputes between the insured and the insurer.
  - Arbitration is less time-consuming and less expensive than judicial proceedings.
  - Arbitrators can be chosen from a panel of individuals who have specialized expertise.

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Practice

- Which one of the following statements is correct regarding a standard, unendorsed directors and officers (D&O) liability policy?
  - A. It typically includes defense costs in the definition of loss.
  - B. It seldom includes a deductible.
  - C. It seldom covers wrongful acts that occurred before the policy period.
  - D. It typically provides 6- to 12-month automatic tail coverage.

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Specialty Directors and Officers (D&O) Coverages

Objective III

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Occupation-Specific Policies

- A number of insurers have created specialty policies for specific fields.
  - School boards, municipalities, not-for-profits.
- These policies are more likely to include employment practices liability coverage.
  - Sometimes include certain professional liability coverages.
  - Often include coverages that are specific to the particular occupation.

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Outside Directors Liability Policies

- Corporation may requests its directors to serve as outside directors for an unaffiliated org.
  - Unaffiliated organization may have inadequate or no D&O coverage.
- Approaches to covering outside directors:
  - Adding a coverage extension or endorsement to an existing D&O policy.
  - Obtaining an outside directors liability policy.
    - Claims payable will not reduce the aggregate limit under regular D&O policy.

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Separate Coverage

- Reasons directors may find themselves without D&O coverage they thought they had:
  - Cost of defending a claim has depleted the existing policy limits.
  - Aggregate limits have been used up in defending other claims.
  - Bankruptcy court freezes D&O policy.
  - Insurer rescinds the policy due to material misstatements.

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Separate Coverage

- Side A-only coverage covers only the individual liability of the insured directors.
  - Coverage usually applies as excess over any other insurance.
- Some policies are pure excess.
  - Do not “drop down” to take the place of the underlying coverage if it is rescinded.
- Other policies provide for drop down.
  - May cover exposures not covered by corporate D&O, or if D&O policy is frozen.

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Separate Coverage

- Enhanced Side A-Only coverage has broader wording or fewer exclusions than some Side A-only policies.
  - For example, the policy may not have a pollution exclusion or an ERISA exclusion.
  - Limited insured vs. insured exclusion.
- Most of these policies provide that coverage will be as broad as the underlying policy.
  - Will apply if the underlying carrier is financially unable to perform.

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Separate Coverage

- Independent directors liability policy insures only independent director(s) named in policy.
  - Independent directors are not affiliated with the corporation they serve.
  - They may insist on having their own coverage with limits not diluted by other claims.
- Coverage is triggered when corporation does not indemnify the named director for a loss.
  - Can also be triggered if D&O policy is inadequate, invalid, or nonexistent.

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Practice

- John is a Director for ABC Corporation. He is not an officer and has no preexisting business relationship with the corporation. ABC Corporation purchased a directors and officers liability insurance policy to cover liability for wrongful acts or omissions. However, John is concerned that ABC has not purchased enough insurance, and he is also concerned that the existing insurance limits will be diluted by claims against other directors or the corporation. What can ABC do to alleviate John's concerns?
  - A. Increase Coverage A of the directors and officers liability insurance policy.
  - B. Increase Coverage B of the directors and officers liability insurance policy.
  - C. Increase Coverage C of the directors and officers liability insurance policy.
  - D. Purchase an independent directors liability policy.

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Employment Practices Liability Loss Exposures

Objective IV

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Liability Loss Exposures

- Employers face employment practices liability (EPL) exposures under various fed/state laws.
  - Civil Rights Act of 1964 was first major Act.
- Many states have laws that are broader than federal laws.
  - Not all violations of these laws are covered by EPL insurance.

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Laws Affecting EPL Loss Exposures

Statute	Affect
Civil Rights Act of 1964	Prohibits discrimination based on race, religion, or sex. Applies to ERs with 15 or more EEs.
Civil Rights Act of 1991	Authorizes damages up to $300,000 for intentional racial or gender discrimination.
Age Discrimination in Employment Act	Prohibits discrimination against age 40 or older based solely on age. Applies if 20 or more EEs.
Americans with Disabilities Act	Requires accommodations for disabled persons and prohibits discrimination.
Family and Medical Leave Act	Employers with 50+ employees must provide 12 weeks of unpaid leave to care for newborn.

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Laws Affecting EPL Loss Exposures

Statute	Affect
Fair Labor Standards Act	Establishes minimum wage and overtime rates, and regulates employment of children.
Worker Adjustment and Retraining Notification Act	Requires employers to provide 60 days notice for plant closings or mass layoffs.
COBRA	Gives workers and families who lose health benefits the right to continue coverage.
ERISA	Sets minimum standards for pension and benefit plans.

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Discrimination Claims

Type	Overview	Detail
Overt discrimination	Intentional	Observable action that discriminates.
Disparate treatment	Unequal treatment	Unfair treatment of someone in comparison to how similar individuals are treated.
Disparate impact	Adverse impact	Application of personnel policies to all employees that discriminates.

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Wrongful Termination Claims

- Wrongful termination of employment accounts for the majority of EPL cases.
  - Includes constructive discharge, which occurs when employees resign because of unendurable conditions.
- Traditionally, the employment at will doctrine has allowed employers or employees to terminate the relationship at any time.
  - Several states base an exception to this doctrine on the theory of implied contract.

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Sexual Harassment Claims

- Sexual harassment is unwelcome sexual advances made as a condition of employment.
  - Some claims are based on a hostile work environment.
- To prevail, an employee generally must prove:
  - They are a member of a protected class.
  - They were subjected to unwelcome harassment that affected a term or condition of employment.
  - The employer knew about the harassment.

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Retaliation Claims

- Employment practices liability (EPL) claims can arise from an employer's alleged retaliation for an employee's legitimate act.
  - Retaliation claims may be combined with claims of race or age discrimination.
- Retaliation claims have increased since the mid-1990s.

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Practice

- Amaco Inc. was concerned that its health insurance premiums were increasing, so they instituted a wellness program for their employees. The wellness program provided that an employee would receive a bonus if their body fat percentage dropped below 20%. A group of women filed a lawsuit against Amaco asserting that the provision penalized women. This is an example of:
  - A. Intentional discrimination.
  - B. Overt discrimination.
  - C. Disparate treatment.
  - D. Disparate impact.

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Employment Practices Liability Insurance

Objective V

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EPL Insurance

- CGL policies exclude coverage for EPL losses.
  - Employers liability exclusion.
- EPL insurance coverage includes indemnity and defense costs.
  - Most policies are written on independently developed forms.
- EPL policies resemble D&O policies.

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Insuring Agreement

- EPL policies typically agree to pay losses resulting from claims for wrongful acts.
  - Wording similar to D&O policy.
- Definitions of wrongful acts:
  - Broad form – no specific listing of covered offenses.
  - Named perils – definition can range from brief listings of a few offenses to exhaustive lists that provide coverage equal to broad forms.

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Definition of Employee

- Coverage is linked to employment status.
  - Definition of employee can include any natural person who is or was an employee.
  - Can include part-time employees.
  - Some policies include leased employees.
- Some policies specifically exclude claims made by independent contractors.
  - Some cover independent contractors' claims.

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Exclusions

- Exclusions often included in EPL policies:
  - Claims arising out of circumstances reported under a prior EPL policy.
  - Fraud or deliberate violation of regulations.
  - Contract liability.
  - Bodily injury or property damage other than emotional distress or mental anguish.
  - Violation of ERISA, COBRA, or similar Acts.
  - Workers compensation obligations.
  - Costs to install accommodations for disabled.

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Exclusions

- Some EPL policies exclude claim awards that include back pay.
  - Alternatively, may only cover back pay awards for certain types of claims.
  - Back pay is income the employee lost before a judgment was awarded.
- Front pay is income that would have been earned between the judgment and reinstatement.
  - Could also be an award to compensate the employee for lost future income.

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Added Coverages

- Additional coverages in EPL policies:
  - Third-party discrimination coverage – covers harassment or discrimination claims made by customers, suppliers, or non-employees.
  - Workplace violence coverage – covers violence not covered under workers comp.
    - Includes costs of obtaining consulting services to help cope with turmoil.
  - Reputation management costs – coverage could apply to the expense to retain a public relations firm or crisis management firm.

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Risk Control Services

- Some insurers offer comprehensive risk control services to their EPL insureds.
  - Usually aimed at small to medium-sized firms.
- Services include:
  - Training programs.
  - Review of employee handbooks.
  - Access to attorneys to discuss a problem.
  - Confidential EPL audits.
  - Consultants to help the insured prepare its response to an EEOC hearing.

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Practice

- Which one of the following is an additional coverage that may be offered by an insurer in an EPL policy?
  - A. Second-party discrimination.
  - B. Workplace safety (OSHA).
  - C. Unemployment compensation.
  - D. Reputation management.

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Fiduciary Liability Loss Exposures

Objective VI

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Fiduciary Liability Loss Exposures

- Fiduciary liability loss exposures arise out of the possibility that beneficiaries of plans file a claim against plan administrator.
  - These claims are becoming more common, and can be significant.
- Claims are often based on:
  - Employee Retirement Income Security Act.
  - Duties and liabilities of fiduciaries.
  - Health Insurance Portability and Accountability Act.

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ERISA

- ERISA governs various benefit plans.
  - Includes retirement plans and group health benefit plans.
  - Violators are subject to penalties such as fines and loss of favorable tax treatment.
- Government bodies are exempted from ERISA.

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Fiduciary Duties

- Duties of a plan fiduciary:
  - Prudence – must carry out duties with the care and skill of a prudent person.
  - Loyalty – actions must be in the best interests of the plan and its participants.
  - Diversification – must diversify investments.
  - Adherence – must act according to the plan documents and applicable law.
- These duties are similar to duties of a corporate director.

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Fiduciary Duties

- Fiduciary duties involve a high standard of care.
  - Duty of loyalty may present issues for fiduciaries who are also officers or directors.
- If a fiduciary breaches a duty, the fiduciary is personally liable to the plan for losses.
  - May also be subject to a fine and an action for monetary damages.
- A fiduciary may be liable for the breach of a duty by another fiduciary if there is no attempt to correct the breach.

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HIPAA

- Major objectives of HIPAA:
  - Sets standards for health insurance portability.
  - Limits exclusions for preexisting conditions.
  - Prohibits discrimination based on health-related factors.
  - Improves disclosure about group plans.
- HIPAA also calls for the protection of employee medical information.

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Practice

- Apache Energy is a company involved in the trading of complex energy derivatives. Their board of directors is compensated quarterly based on the performance of the company's stock price. The board of directors approved investment in the company's stock in their employee's pension plan. The pension plan was already invested in various equity and fixed income mutual funds. The company began to fall on hard times, and the board froze transfers out of the company stock investment option, fearing sales of the stock would put downward pressure on the stock price. Which one of their fiduciary duties have they violated by focusing only on the impact to the stock price?
  - A. Loyalty.
  - B. Prudence.
  - C. Diversification.
  - D. Adherence.

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Fiduciary Liability Insurance

Objective VII

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Fiduciary Liability Policies

- Fiduciary liability policies closely resemble D&O and EPL policies.
  - Coverage applies to wrongful act claims.
  - Coverage is normally on a claims-made basis.
  - Options for extended reporting periods are comparable to those for D&O policies.
  - Defense coverage can be on either a duty-to-defend or reimbursement basis.
  - Covered defense expenses are usually included within the overall limit.

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Persons and Organizations Insured

- Persons and organizations insured:
  - Sponsor organization (named insured).
  - Insured plans.
  - Director, officer, or employee of any insured.
    - But only in their capacity as a fiduciary or trustee of an insured plan.
  - Anyone administering an insured plan.
- Multi-employer plans are usually not covered.

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Definition of Wrongful Act

- Wrongful act usually includes:
  - Breach of responsibilities imposed by ERISA or by statutory law.
  - Any other matter claimed against insureds because of their service as fiduciaries.
  - A negligent act, error, or omission solely in the administration of any insured plan.

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Exclusions

- Many exclusions in fiduciary policies are similar to those in D&O and EPL policies.
  - Criminal acts, fraud, etc.
- Differences include:
  - Workers compensation exclusion typically provides coverage for COBRA claims.
  - Exclusion of fines and penalties often covers certain penalties imposed by ERISA.
  - Excludes losses resulting from insured's failure to collect employee contributions.

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HIPAA

- HIPAA applies to employers with more than 50 employees.
  - Allows for both civil and criminal penalties.
  - Criminal penalties are not insurable.
- Coverage for civil fines for unintentionally violating HIPAA privacy rules is generally limited to $25,000.

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Other Coverage

- Employee benefits liability coverage can be added by endorsement to a CGL policy.
  - Endorsement provides coverage for administrative errors or omissions.
  - Coverage may be sufficient for some small employers whose plans are administered by agents who have fiduciary coverage.
- ERISA requires all fiduciaries to be bonded.
  - Organizations that administer benefit plans purchase fiduciary bonds.

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Practice

- Claims arising from which one of the following would typically be covered in a fiduciary liability policy?
  - A. Certain fines and penalties imposed by ERISA.
  - B. Failure to collect required employee contributions.
  - C. Criminal or fraudulent acts.
  - D. Acts that occurred before the retroactive period.

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