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Private Directors Association Newsletter July 2017
D&O Insurance is Important for Private Companies, Too

Upcoming Events

Ravinia A Night to Remember / Stephen Stills and Judy Collins
 July 26, 2017
 Starts 5:30 PM
 Ravinia Festival
 Highland Park, IL 60035

Second Annual PDA Golf Outing
 August 8, 2017
 Starts 11:30 AM
 Rolling Green Country Club
 Arlington Heights, IL 60004

ESOPS as a Viable Liquidity Option for Sale or Succession
 September 27, 2017
 Starts 5:00 PM
 McDermott, Will & Emery
 444 West Lake Street
 Chicago, IL, 60606

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Contributing Editor: *Kevin M. LaCroix is an attorney and Executive Vice President, RT ProExec, a division of R-T Specialty, LLC. RT ProExec is an insurance intermediary focused exclusively on management liability issues. Kevin has been involved in directors' and officers' liability insurance for over 30 years. Kevin is a member of the Private Directors Association and can be reached at*
 Phone: (216) 378-7817
 E-mail: kevin.lacroix@rtspecialty.com



Executives at companies whose securities are publicly traded typically don't need to be persuaded that their company needs D&O (Directors and Officers) insurance. They understand that the exposures public companies face make D&O insurance indispensable. However, the view of some private company managers may be different, particularly for officials at companies whose shares are very closely held. These company officials may believe their company has little risk of getting hit with a D&O lawsuit and as a result conclude that they don't need D&O insurance. However, the reality is that D&O insurance is an indispensable part of every company's risk management arsenal, whether or not a company's shares are listed.

Why Private Companies Need D&O Insurance

As discussed in a May 2, 2017 memo from the Pillsbury law firm entitled "Reality Check: Private Companies Need Directors' and Officers' Insurance Too", private companies face "increased scrutiny" from a variety of sources, and the volume of lawsuits and investigations against private companies "continues to rise" and D&O insurance "provides an invaluable means to cover the ever-increasing costs incurred by companies to combat such actions."

I frequently run across private company officials who are convinced that, because they have only a very small number of shareholders or owners, they will never have a D&O claim and so they don't need to buy D&O insurance. As the authors of the law firm memo put it, "This business decision may in fact be a mistake." The list of potential claimants on a private company D&O claim is not limited just to shareholders or owners. D&O claim plaintiffs also could include customers, vendors, suppliers, regulators, creditors, and a host of others as well.

The fact is that private company D&O claims are frequent and expensive. As Chubb noted in its 2016 private company risk management survey report, more than a quarter of all companies reported experiencing a claim in the last three years. The average reported loss was \$387,000. Among companies responding to the survey that do not buy D&O insurance, the average reported loss was almost \$400,000.

The Broad Scope of Coverage Available

The coverage available under private company D&O insurance policies is materially broader than the coverage afforded under public company D&O insurance policies. The entity coverage available under public company D&O insurance policies generally is limited to securities claims, while private company D&O insurance policies contain no such limitations, meaning that private company D&O insurance policies provide broad balance sheet protection for the insured companies.

An aspect of private company D&O insurance that many prospective buyers often overlook is that the coverage afforded extends far beyond just protection in the event of a lawsuit. As the law firm memo's authors point out, most private company D&O insurance policies define the term "Claim" broadly to extend far beyond just lawsuits.

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Today, the typical definition of a claim is “a written demand for monetary, nonmonetary or injunctive relief” as well as “a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, nonmonetary, or injunctive relief,” subject to all of the policy’s terms and conditions. This broad wording means that a lawsuit is, as the memo’s authors put it, “only one mechanism by which coverage may be triggered.”

In the current D&O insurance environment, private company D&O insurance frequently is offered as one part of a modular management liability insurance policy that combines several management liability insurances in a single combined product. For example, the policy might include not only D&O insurance, but employment practices liability insurance (EPL), fiduciary liability insurance, crime, or even kidnap and ransom insurance. These policies are usually structured with a single declarations page specifying the policy period and the limits of liability, a single policy form specifying terms and conditions common to all coverage, and then separate policy forms for each of the coverage lines in the combined program.

Private Company D&O Insurance Entity Liability Exclusions

Because the entity coverage protection afforded on private company D&O insurance policies is broader than the securities claim-only entity coverage protection afforded under public company D&O insurance policies, the private company D&O insurance policy typically includes exclusions that are usually not found on the public company D&O insurance policy. For example, the private company D&O insurance policy typically will include an exclusion for entity intellectual property claims. Other common entity exclusions that may be found on private company D&O insurance policies include antitrust and deceptive trade practices exclusions; professional services exclusion; and a contractual liability exclusion.

Securities Offering Exclusion

Yet another private company D&O insurance policy exclusion that can be critically important is the public offering exclusion. Private company D&O insurers do not intend to cover exposures arising from the issuance or subsequent public trading of company’s securities, so private company D&O insurance policies typically include a public offering exclusion. A particular concern with these kinds of exclusions is that they sometimes are written so broadly that they could preclude coverage arising from pre-IPO activities. If the company is preparing to go public, its senior executives undertake a variety of activities that may create potential liability exposures. If the company does not complete the offering and claims result, the private company D&O insurance policy will be called upon to respond to the claim.

Conclusion: The bottom line is that every well-advised company - whether publicly traded or privately held - should have D&O insurance. The concerns arising with respect to the entity liability exclusions discussed above as well as with respect to the securities offering exclusions are good illustrations of the fact that for all D&O insurance buyers, including even private company D&O insurance buyers, it is critically important to associate knowledgeable and experienced advisors in the insurance acquisition process. Without the involvement of this kind of expertise, buyers could wind up with D&O insurance coverage that is not well-suited to the company’s needs and exposures – and even worse, could mean that coverage is not available as intended or expected when claims do arise.

CLICK HERE for a link to further detail in the full article.

Body of Knowledge Topic: Board Operations

Note: Risk & D&O Issues will be the topic of the November PDA Breakfast Meeting