Managing Risk

"Companies get out in front and stay there by raising the standards by which they judge themselves and by which they are willing to be judged."

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D&O: Not Just for Public Companies

Private companies and nonprofits need D&O, too!

Directors and officers liability insurance, commonly known as D&O, protects corporate directors and officers from liability arising from acts or omissions they commit in the course of their official duties. Directors and officers owe the corporation they serve, and its shareholders, three fiduciary duties: the duty of care, or of acting with reasonable prudence in the performance of their duties; the duty of loyalty, or of putting the corporation's interests above their own; and the duty of obedience, or of acting within the scope of their authority. Directors who fail to carry out these responsibilities can be held personally liable if their errors or omissions result in a loss to the corporation or its shareholders.

In recent years, those "official duties" have become more onerous, due to increasing regulatory scrutiny. For example, in 2002, the Sarbanes-Oxley Act became law. In addition to tightening responsibilities for outside auditing companies, the law also placed greater financial oversight responsibility on a company's principal executive and financial officers. These individuals must now agree in writing that they have personally reviewed the corporation's annual or quarterly SEC filings and certify the information contained therein is true to the best of their knowledge. Increased responsibilities such as these have made some individuals who might have served as outside directors in the past hesitate to take an outside directorship.

Other developments have increased outside directors' interest in D&O insurance. Last year, in derivative suits involving Enron and WorldCom, outside directors agreed to contribute personal funds to resolve claims against them. (A judge tossed out the WorldCom settlement agreement because of its potential impact on other defendants; the Enron settlement still stands.)

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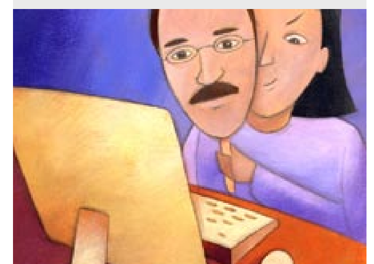
Risk Notes

Cybercrime costs more than "physical" crime, according to nearly 60 percent of U.S. businesses surveyed by IBM. Respondents considered lost revenue, loss of current and prospective customers and lost employee productivity as costs of cybercrime. However, no reliable national statistics on the cost and prevalence of cybercrime exist to date. On a related note, the Bureau of Justice Statistics and the National Cyber Security Division (NCSD) of the U.S. Department of Homeland Security will be sponsoring the first National Computer Security Survey during 2006. The survey aims to "produce reliable national and industry-level estimates of the prevalence of computer security incidents (such as denial of service attacks, fraud, or theft of information)" against businesses and the resulting losses incurred by businesses.



Telecommuting and Injuries

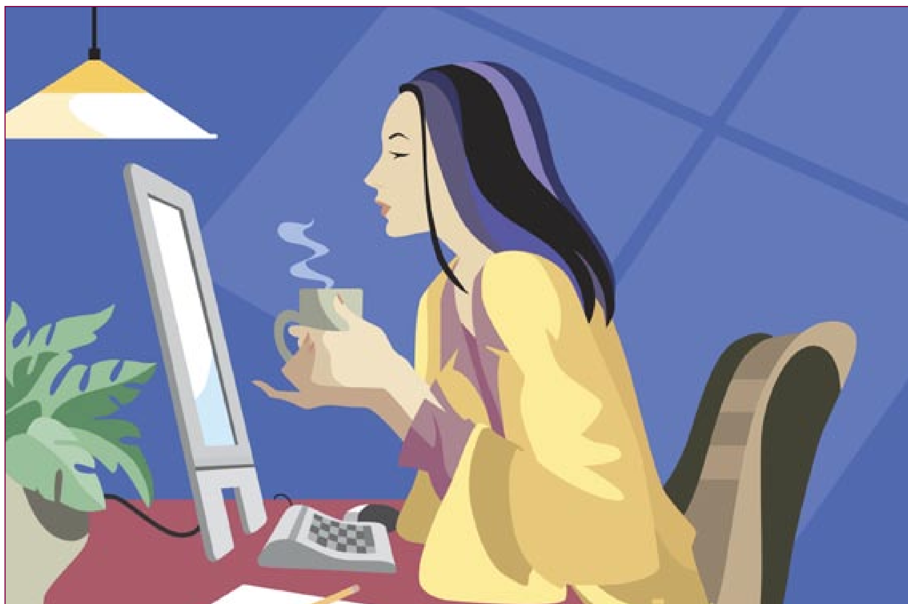
Telecommuting can bring some legal pitfalls for the employer. Read below for some pointers on avoiding them.

With current gas prices, telecommuting has once again become a popular topic of discussion among employers and employees. Whether you already have employees who telecommute or you are discussing such an arrangement for the first time, you will need to prepare for the possibility of employee injuries.

Because a telecommuting location – generally the employee's home – is an extension of the employer's office or jobsite, telecommuting arrangements can create some legal pitfalls for the employer. One such pitfall includes reporting, handling and investigating employee injuries that occur at the location.

First, employers need a clearly written policy for telecommuters. The policy must address the type of work to be performed, establish work hours (whether fixed each day or total hours worked each week), home office and equipment requirements, and other related guidance. The policy must also provide direction to an employee on when and how to report a work-related injury from the telecommuting location, with instructions on how the employer will investigate the injury to determine preventive measures.

Second, employers must understand that workers' compensation laws and benefits cover telecommuting employees. When an injury occurs at the typical worksite, there is generally someone to witness the injury or, at least, a means for the injured employee to report the injury promptly to the employer. When a telecommuter is injured, you may not have any witnesses, he or she may have difficulty in reporting the injury promptly, and since the injury occurs at what is both the employee's workplace and home, the employee has an opportunity to abuse the system.



In addition, an injury occurring at the telecommuting location can fall into a gray area. For example, if an employee slips and falls on the stairs while going from the second floor office to the kitchen to get lunch or a snack, is that "work-related"? Or when the employee goes outside to retrieve the mail, which may include documents from the employer, and slips in the driveway – is that "work-related"?

Third, employers need a plan to provide modified or restricted duty if a telecommuter has an injury. And the employer must also consider ADA (Americans with Disabilities Act) accommodations if the employee is to work from home but does not already have reasonable accommodations for the injury. If the employer elects for the employee to not perform work while recovering (does this make it a lost-time injury?), does this eliminate the employer's need to make a reasonable accommodation in the employee's home?

OSHA and telecommuters

In 1999, OSHA indicated an interest in inspecting telecommuting workplaces, but withdrew the directive shortly after releasing it. This does not prevent an inspection, however, where an employee has a complaint regarding imminent danger from equipment or work practices in which the employer has not provided adequate safeguards.

Additional OSHA requirements might apply to the telecommuting employee, including training (such as the HazComm Standard and access to material safety data sheets, fire extinguisher and evacuation procedures, for example), hearing conservation, respiratory protection and other safety and health standards, depending on the employee's duties.

OSHA also requires the employer to report workplace injuries on the OSHA 300 log, regardless of where the injury occurs. It is necessary, then, to determine and en-

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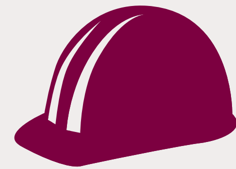

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In a derivative suit, a company's shareholders file a claim on behalf of the company itself, alleging that the directors or officers violated their fiduciary duty. Ordinarily, a corporate charter contains language agreeing to "indemnify," or protect directors and officers from financial liability arising from their corporate duties. However, many states have "good faith" provisions that prohibit insurers from covering directors and officers in suits alleging fraud. In these cases, directors and officers must pay for their own defense costs and, if the plaintiffs' claims are upheld, any settlements. Although Enron had D&O coverage, which can cover attorney fees, the magnitude of the case and the likelihood of the defendant directors losing had the case gone to trial could have prompted the directors' settlement agreements.

Typical D&O claims

Publicly traded companies clearly need D&O insurance to protect their directors and officers from the risk of shareholder suits. According to the 2004 Tillinghast Directors & Officers Liability Survey, only 23 percent of D&O claims against publicly traded companies were brought by employees. For this group, shareholder suits represent the largest risk, although regulators and other outsiders can also file suit against directors and officers. The 2005 Directors & Officers Liability Study also found that the risk of shareholder suits increased with the size of the organization and if it had undergone a merger recently.

Privately held corporations have much lower exposures to shareholder suits. However, shareholders can—and sometimes do—sue directors and officers of private corporations.

Although nonprofits have no shareholders, directors and officers must manage the organization's assets well and in accordance with the bylaws. Considering that some nonprofits have multimillion dollar budgets, their directors' responsibilities can equal those of a publicly traded corporation's. In fact, Sarbanes-Oxley's executive liability and whistle-blower protection provisions apply to nonprofits as well as for-profit corporations.

For nonprofits and privately held companies, employee suits present a much greater risk to directors and officers. Among nonprofits, 96 percent of D&O claims were filed by employees during 2005, according to the Tillinghast survey. Privately held corporations are also more likely to have D&O claims filed by employees rather than shareholders, regulators or others. For these sectors, insurers have developed specialized policies that combine D&O coverage with employment practices liability insurance, or EPLI. In addition to protecting corporate directors and officers from liability relating to their fiduciary responsibilities, it will protect them from employment practices liability claims as well, including:

- Discrimination
- Harassment
- Wrongful termination
- Retaliation
- Wrongful discipline

It's important to note that the D&O/EPLI policy covers only directors and officers—it will not cover managers or supervisors from employment practices claims. If you have significant employment practices liability exposures, you might need a separate EPLI policy. Or, depending on your firm's structure and exposures, a management liability policy might provide the coverage you need.

To obtain a quote on a D&O policy, an insurer will want copies of the following:

- Financial statements
- Resumes of senior managers
- Resume of human resource manager (or person who handles personnel issues)
- Employee manual
- Procedures for handling employment practices complaints, including sexual harassment complaints
- Outlines or description of training provided to managers or supervisors
- Information on labor litigation, employment practices complaints or investigations by the Equal Employment Opportunity Commission
- Information on recent or planned layoffs, including criteria used to select layoff candidates
- Information on recent or planned mergers

We can help you evaluate your D&O and employment practices liability insurance needs. For more information, please call us. ■

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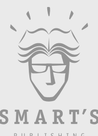
sure that an injury reported by a telecommuting employee is, in fact, work-related. The only way to determine if the injury is work-related is to conduct some form of an injury investigation. An employee must know that the employer can investigate a reported injury, which may mean giving the employer access to the employee's home office.

Other employment laws may apply to telecommuters, such as the Fair Labor Standards Act or the Family and Medical Leave Act. A clearly written policy and position description will define the employer's responsibility in some of these areas, as will requiring telecommuters to "sign-in" and "sign-off" on the company server to track hours worked.

Telecommuting can offer benefits to both the employer and the employee. To minimize the possibility of injuries or employer liability, the employer will want to have a clearly written telecommuting policy that covers safety, minimum home office requirements and injury reporting. Don't take the "out of sight, out of mind" position, as this can leave you wide open to legal and insurance liabilities. Telecommuters require the same level of attention as your regular workforce. For more information on workers' compensation, safety and telecommuters, please call us. ■



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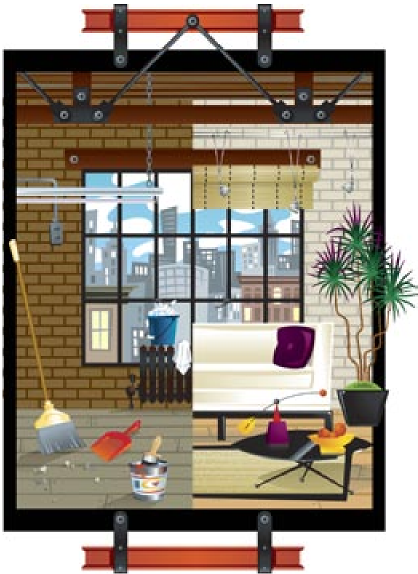

Better Coverage for Improvements and Betterments

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.

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 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.