INSIGHTS: VOLUME XI ISSUE 2 SUMMER 2016

RT ProExec INSIGHTS

PRIVATE COMPANY MANAGEMENT LIABILITY INSURANCE COVERAGE INCONSISTENCIES

The private company management liability insurance industry continues to evolve. While the number of insurers participating in the space is at an all time high and competition is increasing, the breadth of coverage quality varies widely among the policy forms.

Some carriers are still holding back on coverage as a result of the losses that plagued private companies during the aftermath of the most recent recession, others are new to the line and are slowly improving their coverage as they grow their books, still others have policy forms and endorsements that have not kept pace with the new exposures facing privately held companies.

Unfortunately, all too often, some private companies simply renew their management liability insurance programs year after year, without ensuring that their policies contain state of the art terms and conditions. In order to help privately held companies evaluate the quality of their coverage, this article discusses a number of coverage items that should be addressed in private company management liability programs.

First, a few basics, when we refer to private management liability insurance, we are including Directors and Officers (D&O) Liability, Employment Practice Liability (EPL), Fiduciary (FID) Liability and Crime insurance. It is important to emphasize that not all of the terms discussed below are available from all insurers, and with respect to some of the terms, even the insurers that are willing to offer the terms may not be willing to offer them to all policyholders. For example, some insurers may not be willing to offer the broadest terms to companies in certain industries or with certain other characteristics or that have a history of claims. In addition, some insurers may require an additional premium to include some of these items.

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NOTICE OF CLAIM TRIGGER

All private company management liability insurance policies have provisions stating that the policyholder must provide notice of claim to the insurer within a certain time period. While the requirements are relatively straight forward, the reality is that, at times, policyholders do provide late notices to their insurers. The delay in providing notice can happen for many reasons. For instance, the notice may be delayed because the person who knows about the claim and the person responsible for the insurance may not be the same person.

In order to try to eliminate the possibility that a delayed notice might result in the loss of insurance coverage, the notice provision should be modified to provide that the period within which notice must be provided does not commence until one of a short list of specified company officials (usually the CEO, CFO, General Counsel, and, sometimes, the Risk Manager) has become aware of the claim. This protects against the possibility that coverage might be precluded due to late notice simply because awareness of the claim had not made its way to the right people within the company.

ANTITRUST EXCLUSION

Many private company management liability insurance policies contain so-called "antitrust exclusions." This descriptive label for the exclusion is somewhat misleading as these exclusions typically sweep much more broadly than just with regard to antitrust allegations. For example, one "antitrust" exclusion precludes coverage for any claim involving *"any actual or alleged price fixing, restraint of trade, monopolization, or unfair trade practices, including actual or alleged violation of the Sherman Anti-Trust Act, the Clayton Act, or similar provisions [of] any state, federal or local statutory law or common law anywhere in the world."*

The problem with the encompassing language is that many of the management claims that private companies face contain allegations of, for example, deceptive trade practices. Insurers whose policies contain one of these broadly worded exclusions often attempt to deny coverage for these kinds of claims, often arguing that the entire claim – including defense expenses – is barred.

Given the broadly preclusive effect of these kinds of exclusions, private companies should have a strong bias in favor of policies that do not contain this exclusion. Many carriers will remove the antitrust exclusion upon request (an additional premium may be necessary). Even in those instances where the carriers will not remove the exclusion, they may be willing to offer the coverage on a sub-limited basis or on a defense cost only basis.

SOCIAL ENGINEERING FRAUD COVERAGE

There has been an alarming increase in the incidence of "business payment instruction fraud," or as it is sometimes known, "social engineering fraud." In these schemes, a scammer using official seeming email communications, attempts to induce company employees to transfer company funds to the imposter's account. According to the FBI, during the period October 2013 through February 2016, law enforcement agencies have received reports of this type of fraud involving 17,642 victims. Complaints involving these kinds of fraudulent schemes have arisen in every U.S. state and 79 different countries - amounting to over $2.3 billion in losses.

The companies that are the victims of these types of scams may try to recover their losses under their crime insurance policies. However, insurers often seek to deny coverage for the losses, arguing that courts draw a distinction between losses where a thief hacks the insured's computer systems and losses in which the insured voluntarily transfers funds. While the courts generally allow coverage for losses arising from hacking, the courts have found that losses from voluntary transfer of funds, including social engineering losses, are generally not covered as they do not arise "directly" from the use of a computer to fraudulently cause a transfer of property; but rather, they arise from an authorized transfer of funds.

From a policyholder's perspective, the question of whether the traditional commercial crime policies cover this type of loss is at best uncertain. Several carriers are now offering coverage by endorsement to the commercial crime policy for these kinds of losses. The endorsements are designed to provide coverage when an employee is intentionally misled by electronic or written instructions from a person purporting to be a company executive or employee, vendor, client, or customer, to transfer money or property. (Some cyber liability insurers also offer this type of coverage.) However, most of the carriers that are willing to offer this coverage extension will do so only on a sub-limited basis. Often these sub-limits are as low as $250,000 or less. Even if the coverage available is limited, some coverage is preferable to none at all.

SETTLOR LIABILITY COVERAGE

The law draws a distinction between fiduciary liability and settlor liability. Fiduciary liability arises from actions taken in administering employee benefit or health and welfare plans. Settlor liability arises in connection with actions to establish or discontinue the plans. In the past, fiduciary liability insurance carriers have taken the position that their policies provide coverage only for fiduciary liability, but not for settlor liability. Upon request, many fiduciary liability carriers will now agree to include an extension that expressly states that their policies will provide coverage for settlor liability claims, often subject to the payment of additional premium.

As a general matter, it is a good idea for private companies to ensure that their fiduciary liability insurance policies contain the settlor liability coverage extension. This extension may be particularly important in light of the requirements of the Affordable Care Act (ACA) which contains a number of employer mandates. While some of these mandates have not yet taken (or fully taken) effect, companies may take steps to avoid the mandates' financial impacts. Companies that alter or eliminate benefit plans or employment arrangements may be exposed to liability claims (as, for example, happened to one employer that reduced its full-time staff to part-time status in order to avoid an ACA mandate). These types of claims could potentially include settlor liability claims.

CONDUCT EXCLUSION WORDING

These days, the conduct exclusion in most management liability insurance policies contains an adjudication requirement, providing that the exclusion's preclusive effect is not triggered until there has been an adjudication that the precluded conduct occurred. However, the wording of the requirement is not standard. The presence or absence of certain wording could make a difference. The preferred wording will provide that the exclusion does not apply until there is (1) an adjudication in the underlying proceeding (2) that is final, and (3) that is non-appealable.

All three of these requirements are important, and in particular, the specification that the adjudication must be non-appealable. Without this requirement, the carrier may take the position that a judgment of a trial court alone is sufficient to preclude coverage. This could put an insured person in a position where his or her insurance is cut off at the very time when they might need it most – that is, when they want to appeal a trial court judgment that could result in criminal penalties or imprisonment. Not all carriers offer this wording, but the exclusionary language can usually be improved upon request.

CONCLUSION

This short list illustrates that there are nuanced details that could become important in the event of a claim that must be addressed prior to binding a management liability insurance policy. There is, in fact, a long list of other items that should also be addressed prior to purchasing coverage – such as securing favorable coverage to address the JOBS Act's Title IV Regulation A+ offerings and Title III crowdfunding offerings. Indeed, not only is there a long list, but the list is constantly changing as the exposure landscape evolves. That is why it is important for all companies, even small private companies, to ensure that their coverage is placed by an insurance advisor that is knowledgeable and experienced with both the changes in the legal environment and the latest terms and conditions that are available in the marketplace.

ABOUT RT PROEXEC

RT ProExec is the Professional & Executive Liability Division of R-T Specialty, LLC. R-T Specialty, LLC is an independent wholesale insurance brokerage firm that provides Property, Casualty, Transportation and Professional & Executive Liability insurance solutions to retail brokers across the country. Our proven leadership, deep talent pool, and commitment to coverage and service has made us the largest wholesaler in the Professional & Executive Liability insurance marketplace.

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