

# Limiting Liability

How private companies can limit exposure for lawsuits related to management

INTERVIEWED BY ROGER VOZAR

Publicly held companies generally receive greater media attention about scrutiny from shareholders and government regulators than private companies, but that doesn't mean that private companies are immune from lawsuits regarding management activities that can disrupt operations and create a financial burden for the business.

"People think that privately held businesses and nonprofits do not have much exposure. The reality is that there are many lawsuits that are brought by shareholders, employees, regulatory agencies, competitors, and customers that are not covered by general liability insurance and only a Directors & Officers (D&O) policy can provide coverage for an actual or alleged wrongful act, breach of duty, or mismanagement," says Peter Bern, CEO at Levery Insurance Group.

*Smart Business* spoke with Bern about risks private companies face and how D&O insurance can help limit exposure.

## What are some potential D&O claims?

Regardless of your company's size, the legal cost to defend a director, officer, or employee is substantial, as are the potential penalties that can be personally incurred. Due to the personal liability risk – which is not covered under a personal insurance policy – protecting these key individuals and the entity itself is critical.

Private companies have investors, shareholders, creditors, employees that can bring lawsuits alleging wrongful acts, mismanagement, breach of duty, or neglect. Regulatory agencies, suppliers, competitors and customers can also be plaintiffs.

Types of lawsuits include the following:

- Breach of fiduciary duty, including self-dealing and conflicts of interest.
- General business mismanagement and

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- bankruptcy.
- Failure to deliver services.
- Failure to disclose information.
- Disclosing materially false or misleading information.
- Regulatory agency actions.
- Merger and acquisition complications and objections.
- Shareholder derivative actions suits
- Freeze-out mergers forcing minority shareholders to sell stock below fair market value.

## How can companies determine what coverage they need?

Because there is no standardized policy, it makes it difficult to comparison shop. Rates are increasing because of the economy and the amount of claims paid to struggling corporations. It's a sign of the times, with all of the bankruptcy issues, partnership dissolutions and receivership situations that are occurring.

There are special endorsements or enhancements that can be placed on these policies. It's a matter of analyzing needs and selecting the necessary limits and coverages accordingly.

Cost drivers of D&O insurance include company characteristics such as:

- Age. Companies with less experience and shorter history of effective management are riskier.

- Industry. Investment banking and securities, for example, expose executive management to more risk than those experienced by board members of a small nonprofit.
- Financial stability. If a company's finances are unstable, there is a greater chance of becoming insolvent during a lawsuit.
- Litigation history. Insurers will analyze a company's history of previous lawsuits.

## Is D&O coverage becoming more commonplace?

It's been around for a long time, but it had been very cost prohibitive. Also, directors and officers had thought it wasn't necessary to purchase coverage if the company wasn't publicly traded. But even nonprofits have exposure. They have volunteers donating time, making decisions and moving money; D&O covers them if there is mismanagement.

Without D&O coverage, executives are not protected personally — homeowners insurance does not respond because business pursuits are excluded.

Since there is no such thing as a "standard" policy, a professional insurance agent is invaluable when purchasing D&O coverage. They will understand your organization and can help design a policy that will meet the needs of the directors and officers, shareholders, and the entity itself. ●