



Davis Wright
Tremaine LLP

DEFINING SUCCESS TOGETHER



Monthly Business CLE

Private Company Litigation Risks and Risk Management



- Risk Management
- Directors & Officers Coverage
- Broker Selection
- Questions



- Corporate Formation
- Business Practices
- Insurance Program
 - Budgeting tool to provide economic certainty
 - Traditional property and casualty (auto, property, and general liability)
 - Specialized lines (directors & officers, EPLI, employee benefits, fiduciary, and pollution)



- Coverage A – Non-Indemnifiable Claims
 - Insures past, present, and future directors and officers when indemnification is not available
- Coverage B – Corporate Reimbursement
 - Reimburses the company for its indemnity obligation to its directors and officers
- Coverage C – Entity Coverage
 - Insures the corporate entity itself when named

Why Private Companies Need D&O



- Recent Survey of Privately Owned Companies:
 - 26% have had a D&O-type lawsuit within 5 years
 - Average D&O-type lawsuit cost: \$308,475
 - Average claim for those that purchased D&O: \$129,625
 - Average claim for those that self-insured: \$408,469
 - Top reasons given for not purchasing D&O insurance:
 - Saw no need
 - Believed risk of loss was small
 - Believed claims covered elsewhere

D&O Illustrative Claim Examples



- **Interference with Competitor's Contract:**
A company recruited a top sales executive who had an employment contract with a competitor company. The competitor sued the company for damages suffered as a result of losing its top sales producer on the grounds that the company interfered with the competitor's contractual relationship with its employee. **Defense expenses were in excess of \$250,000 and the competitor was awarded damages of \$600,000.**
- **Supplier Detrimental Reliance:**
A retailer advised one of its suppliers that it ought to increase inventory because business was expected to increase significantly. Business did increase for the retailer but it decided to use a different supplier for the increased inventory. The original supplier sued the retailer alleging that he relied on the retailer's promise of more business and suffered damages as a result of having relied on that promise. **The matter was eventually settled for \$500,000.**

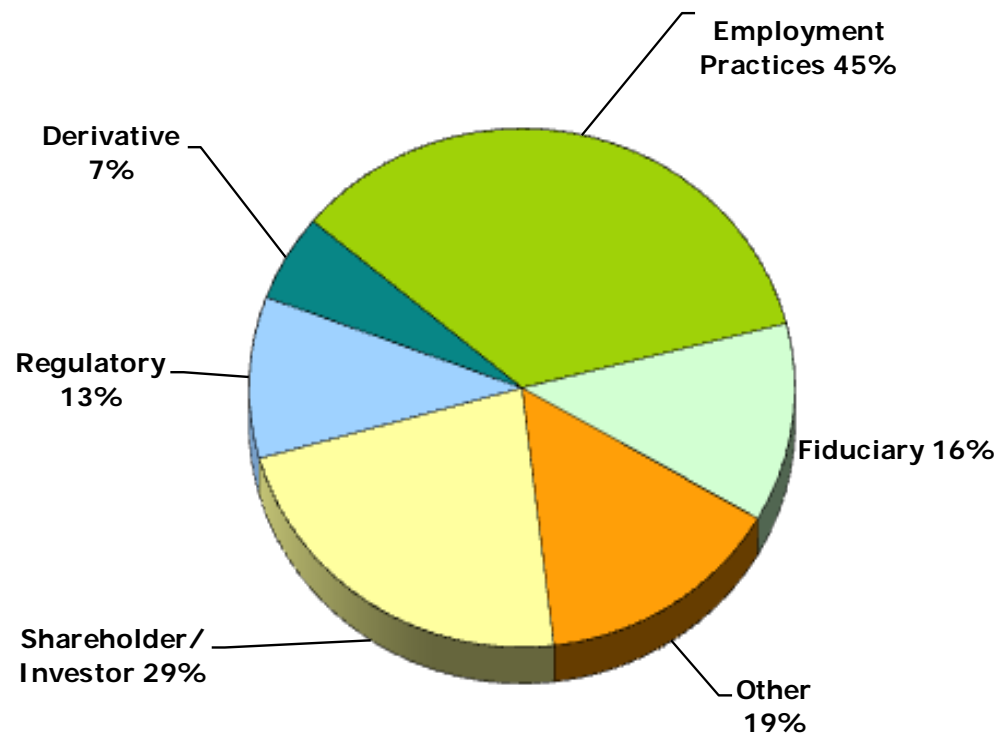
D&O Illustrative Claim Examples



- **Derivative Breach of Fiduciary Duty:**
Investors filed a \$5 million derivative lawsuit against a private company alleging breach of fiduciary duty. The investors claimed that some of the company's officers had personal connections to the third-party contractor hired to re-tool the company's assembly line and hired that contractor to further their personal interests, not the interests of the company. Other officers and directors were alleged to have either knowingly colluded with one another, or at least breached their duty of care in undertaking the project without properly investigating the qualifications of the contractor. **The suit settled for \$1.5 million with an additional \$150,000 for attorneys' fees.**
- **Interference with Business Relations:**
During a press conference the president of a service company stated that the success of his company was due in large part to a competitor's lack of customer service and inferior product. The competitor filed suit alleging that the president had negligently interfered with business relations. **The jury agreed and awarded the competitor \$2 million in damages. The attorneys' fees for this case amounted to \$150,000.**



D&O Claims by Type (Past 10 Years*)



Other Claims from customer, suppliers and other 3rd parties

* Woodruff, Sawyer, and Company

Claims and Cases Examples



- Raising Capital
 - Self-dealing
 - Transaction if directors/officers/other companies
 - Failure to investigate
 - Lack of disclosure
 - Insurance Issues
- Merger & Acquisition
 - Lack of due diligence
 - Self-dealing/related entities
 - Insurance Issues
- Shareholder Disputes
 - Shareholder disputes
 - Misrepresentation/omissions
 - Insurance Issues
- “Job Hopping” Claims
 - Misappropriation of trade secrets
 - Breach of Contract
 - Insurance Issues
- Regulatory Investigations
 - SEC
 - State Securities Regulators
 - Federal and State Antitrust
 - OSHA

Why Should a Business Lawyer be Concerned? Client Knowledge



- Equity Structures
 - Form of entity have impact
 - Shareholders inside vs. outside
 - Equal ownership or minority positions
 - Partnerships/LLC's issues
 - Lack of disclosure
 - Executive compensation
- Internal Business Practices and Impact on Claims
 - Inside loans to officers/directors
 - Stock ownership for employees (ESOP)
 - Transactions with companies affiliated with directors/officers
 - Competency/Independence of the board
 - CEO who is controlling equity holder
 - Compensation control
 - Dividend/payment Distributions
- External Business Environment
 - Competitive market segment
 - Proprietary or other trade secrets involved
 - Cross solicitation of employees



- Panel counsel/attorney selection
- Duty to defend vs. reimburse/indemnify
- Entity coverage
- Manuscript endorsements:
 - Coverage expansions for known potential changes in operations
 - Limit or eliminate exclusions to coverage



- Policy terms vary significantly
- D&O is not a commodity purchase
- Vendor sophistication
- Vendor resources



Broker Selection (RFQ)

- Single broker selected
- Contract for brokerage services executed
- Fee-based cost model (full or partial)
- Express service standards
- Broker-preferred carriers quote

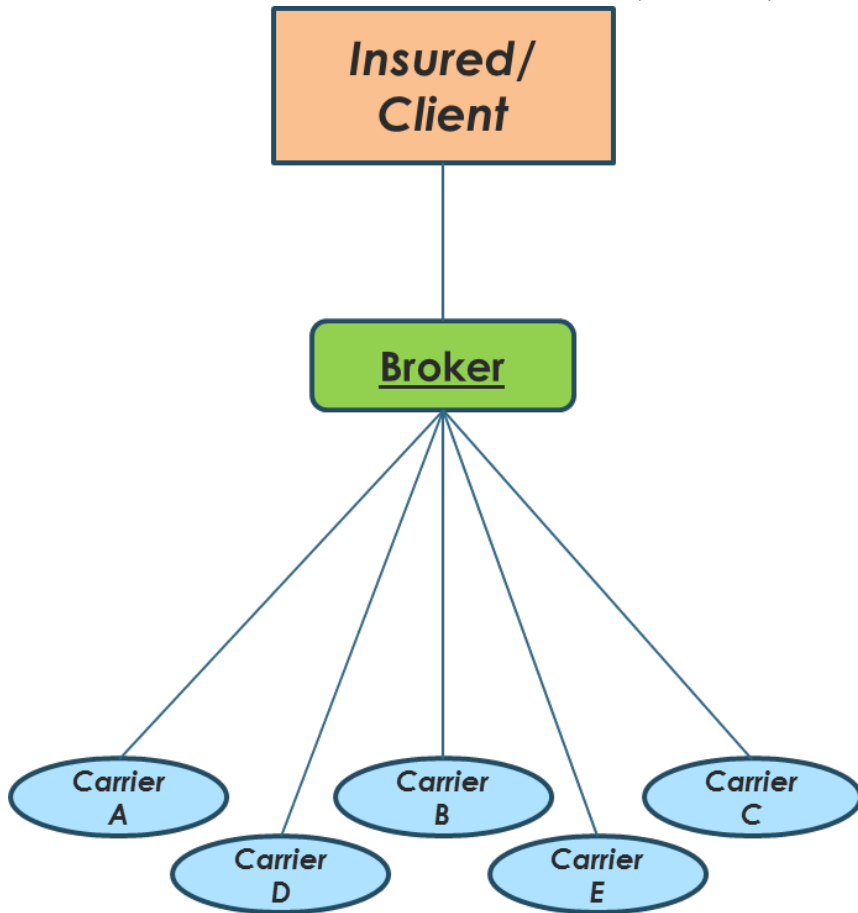
Market Assignment (RFP)

- Pre-qualify multiple brokers
- Assign carriers by broker
- Select preferred broker and carrier team from proposals
- All assigned carriers quote

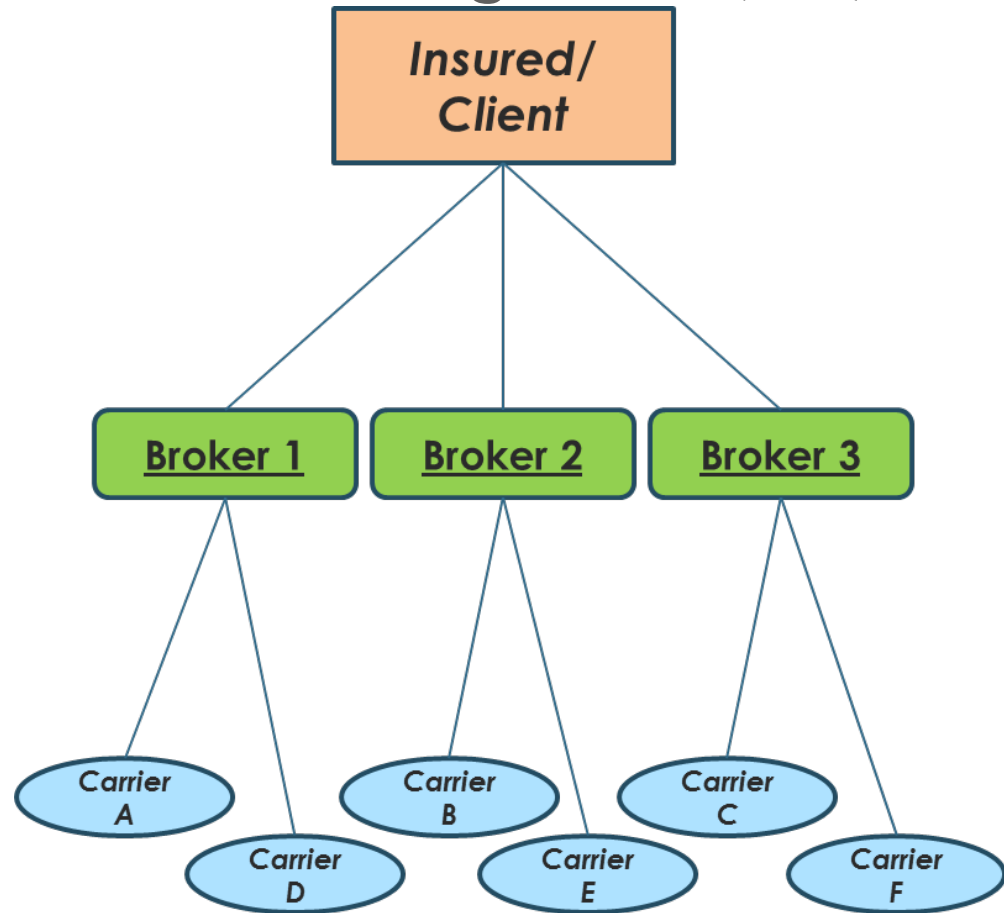
Broker Evaluation & Selection Models



Broker Selection (RFQ)

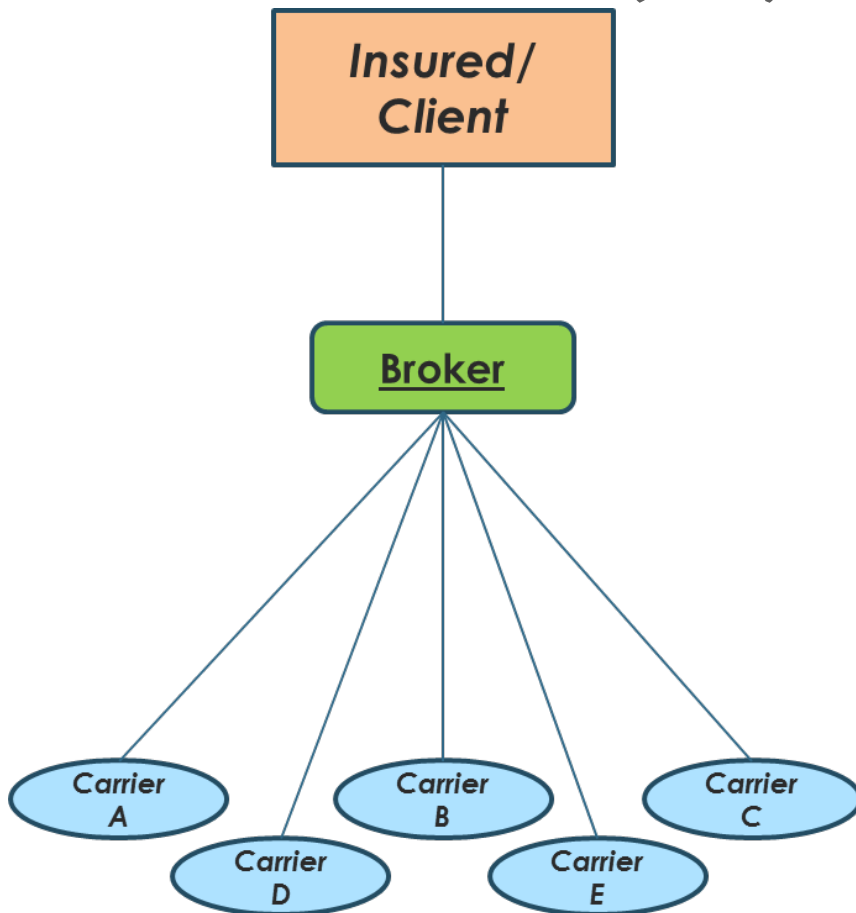


Market Assignment (RFP)





Broker Selection (RFQ)

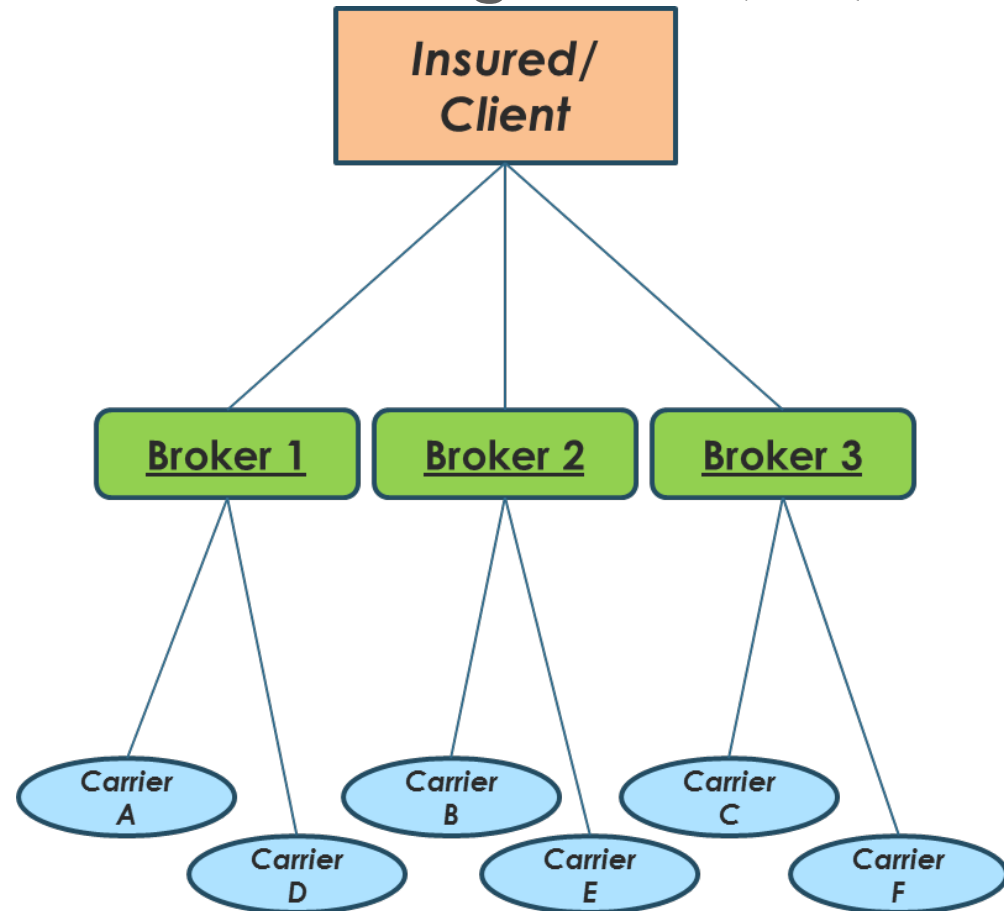


- Benefits:
 - Service
 - Relationship
 - Broker revenue limits
- Concerns:
 - Contract terms
 - Carrier steering
 - Other compensation (contingencies, overrides, wholesale subsidiaries)
 - Market access



- Benefits:
 - Total program cost
 - Market coverage
 - Creative structure
- Concerns:
 - Service standards
 - Transition costs and risks
 - Broker compensation
 - Contract terms (if any)

Market Assignment (RFP)



Broker Relationship Areas of Focus



Key Brokerage Contract Provisions:

- Indemnification clauses (limitations on causes or dollar amounts)
- Confidentiality, data security and privacy (HIPAA, FCRA, etc.)
- Compensation limitations (contingencies, related companies, etc.)
- Broker licensing requirements
- Professional liability insurance requirements (errors & omissions)
- Service standards

Disclosures to Limit Carrier Steering:

- Broker's carrier premium report by line of coverage
- Broker's report of carriers with contingency arrangements

Hybrid Model Considerations:

- Incumbent preferences
- Frequency of partial (carrier-only) and full (carrier and broker) marketing effort





▪ Everett Jack, Jr.



Litigation Partner

- Complex corporate and commercial litigation
- Officer and director defense
- Employment
- Insurance coverage

▪ James G. Parker



Litigation Associate

- Insurance intermediary defense
- General corporate and commercial litigation
- Broker RFP/RFQ business counseling
- Insurance coverage