

Helping Small to Mid-Size Privately Held Companies and Non-Profit Organizations Mitigate Management Liability Risk

While more than 95 percent of America's Top 1000 companies currently purchase directors and officers (D&O) coverage, estimates are that fewer than 10 percent of privately-held companies and non-profit organizations have made D&O coverage part of their overall risk-management strategy.

Since most small and mid-sized companies are not publicly held, their officers and directors may believe their organizations are immune from the risks associated with running a publicly held company. In reality, these organizations are often confronted with similar risks as their publicly traded counterparts. One lawsuit stemming from a breach of fiduciary duty, wrongful employment act or misappropriation of funds can wreak havoc on a mid-sized organization. And an act of employment crime can put a smaller organization out of business. As David Donovan, a vice president of Zurich, observes, "While the magnitude of claims filed against these entities is typically not as large in absolute terms as their publicly traded counterparts, the financial damage still can be great."

Small to mid-size companies and non-profit organizations risk exposure

Many of these same companies are exposed to a number of management liabilities beyond D&O exposure, and most are not properly mitigating against these potentially catastrophic risks. Privately held companies' potential liabilities fall into three major categories: (1) employment practices liability (EPL), including sexual harassment, discrimination, and wrongful termination; (2) patent and copyright violations, such as theft or disclosure of trade secrets, customer lists, and other intellectual property; and (3) financial operations liability, including claims arising from bankruptcy, insolvency, and business and investment valuation. Non-profit organizations also have EPL as a primary concern in managing day-to-day operations and grapple with such additional matters as donor lawsuits, misappropriation of funds, and excessive executive pay.

There are also a host of emerging issues that threaten to increase these liabilities. For instance, mergers and acquisitions can trigger a variety of EPL claims resulting from staffing reductions and relocations. In addition, merger and acquisition activity can trigger claims from minority shareholders alleging lack of true valuation of

their ownership interest in the company. Courts are also increasingly recognizing insolvency as a cause of action against directors and officers, who are alleged to have fraudulently or negligently extended the life of a company, thereby eliminating the possibility of payment for goods and services.

Minimizing management liability risks

Such liabilities would be reason for concern in any case, but they are especially troublesome for privately held and non-profit entities, which tend to be far less protected against these risks than are larger organizations.

Fortunately, these small to mid-size entities can take steps to minimize these risks without spending inordinate amounts of time or money. First is simply to recognize that, like their larger counterparts, they too confront a variety of potentially financially crippling risks. Second is to intelligently survey the options, including D&O and EPL coverage, for indemnifying against these risks. And third is to establish a formal risk management approach,


including the codifying of protective practices in hiring, personnel management, budget allocations, and financial management.

An experienced insurer can add value in such arenas.

For example, in claims management, a mis-timed suite may result in a large jury award, while the exposure may be limited by an insurer that understands the nuances of EPL litigation. Finally, while regulations such as Sarbanes-Oxley

do not apply to privately held and non-profit organizations, these organizations are well advised to incorporate aspects of the law's provisions into their operations, thus demonstrating their willingness and commitment to adhere to such corporate governance practices at a time when accountability for these is being scrutinized.

In the end, the benefits of these small steps can be substantial. Notes Zurich's David Donovan: "Understanding and acting upon the available options can help strengthen the ability of both privately held firms and non-profit organizations to properly protect themselves against the potentially catastrophic risks of management liability."



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