

# THE MANAGEMENT FILE

## RISK MANAGEMENT STRATEGIES FOR DIRECTORS AND OFFICERS

Insight for business owners and risk managers provided by Brier Grieves Agency



While a senior executive position brings many rewards, it also carries significant risks that put your financial net worth at stake. Expect that every decision you make as a director or officer has the potential to be scrutinized by clients, employees, shareholders, and other directors and officers, and stakeholders may file a lawsuit if they believe a decision you made adversely affected their best interests.

The risk of litigation deters some from seeking an executive management position all together; and those who do may be nervous to make decisions due to the threat to their personal assets and professional reputation. What can be done to mitigate these risks?

One significant loss control strategy is to maximize protections, such as through indemnification and directors & officers (D&O) liability insurance, provided by the company. Before accepting a position, it's best to review that these protections are in place, but this can also be done during renegotiation. This article briefly discusses three risk management strategies to consider before signing or renegotiating your contract.

### 1. Seek Out a Corporate Structure Most Favorable to Directors and Officers

How much do you know about the company you are going to work for? Reviewing the company's corporate governance practices to ensure they are sound is a good strategy for anyone seeking an executive position.

To determine if a company's corporate structure is solid, consider the following:

- What kind of orientation, training and education does the company provide for new directors and officers?
- Does the company have internal policies that define its ethical standards and legal guidelines?

- Who are the various people involved with the company and what areas of liability do they pose?
- Does the company have a history of D&O lawsuits?

It's important to learn as much as possible about the company before you accept an appointment. Balancing the interests of various company stakeholders—employees, customers and shareholders—can be difficult. No matter how new to a position, directors and officers may be held personally liable for poor decisions. Claiming ignorance is usually not a viable defense in these instances.

### 2. Request Indemnification Provisions in Your Contract

Nearly all companies offer indemnification to their directors and officers. Indemnification means that the organization compensates a director or officer for losses incurred during his or her defense in a D&O lawsuit. Usually governed by the law in the state in which the company incorporated, some firms choose to expand their indemnification coverage beyond what is required by the state statutes. Well-written indemnification clauses attract talented directors and officers, as they are confident to make decisions knowing the organization will absorb the cost of defending their honesty and integrity.

Located in a company's bylaws or articles of incorporation, indemnification clauses generally state what defense expenses are covered. The language of an indemnity clause is important. Be aware that many companies haven't reviewed their indemnification provisions in years, and be careful that the clause is not "boilerplate." If the company does provide the advancement of defense fees, this should be explicitly dictated in your contract or in the bylaws. In some cases, judgment and settlement costs may also be reimbursed.

Verify whether the company would advance expenses on a permissive (discretionary) or mandatory basis:

- **Permissive.** Permissive indemnification means that the organization has the power, but not the duty, to indemnify its directors and officers, and each case is reviewed by the board of directors on a case-by-case basis. Typically, this is only provided when the director or officer acts in “good faith.”
- **Mandatory.** Mandatory indemnification means that the organization is *required* to indemnify its directors and officers. The indemnified individuals do not need to demonstrate that they acted in good faith or that they were free from wrongdoing, only that the claim against them was defended successfully.

While indemnification is steadfast protection for directors and officers who act in good faith, it has two limitations:

1. **Shareholder derivative lawsuits.** If a director or officer is found liable in a shareholder derivative suit, he or she is not indemnified because the corporation would be paying itself.
2. **Insolvency** also prevents a company from honoring indemnification obligations.

### 3. Assess the Company’s D&O Insurance Coverage

Settling lawsuits—even if found innocent—can be costly, and can bankrupt a company, or an individual director or officer. Many companies also choose to purchase D&O insurance to protect their executives from legal expenses and personal liability exposures not covered by indemnification.

Unfortunately, D&O insurance doesn’t come in a one-size-fits-all policy. If a previous organization you worked for had D&O insurance, it’s not safe to assume your new employer will have the same extent of coverage.

Your foremost consideration should be: Does the company even offer D&O insurance? D&O insurance covers non-bodily injury claims, such as employment practices and misappropriation of funds. Consider that Commercial General Liability and Umbrella policies usually do not cover management liability lawsuits.

If the company does have D&O insurance, then analyze the extent of the coverage. What are the monetary limits of coverage? Are there exclusions in the policy? Many D&O policies do not cover employment-related claims; separate Employment Liability Practices insurance must be purchased to cover those risks. Along the same lines, Fiduciary Liability is an additional type of insurance that protects executive management from exposures related to the Employee Retirement Income Security Act (ERISA).

### Preparing for Your Position

A company can offer you all of the necessary protections in the event of a lawsuit, but it’s a best practice to exercise personal risk management. This includes the following:

- Upholding your fiduciary responsibilities every time you make a decision
- Engaging shareholders with consistent communication
- Knowing the ins and outs of the appropriate regulations, such as the Dodd-Frank Act, the Sarbanes-Oxley Act and the Foreign Corrupt Practices Act, that impact your company

Contact Brier Grieves Agency today to discuss D&O risks and how to protect yourself.