

Insurance: Cover Me

by [John Gray](#)

Corporate liability insurance is a must. But will it be there for you when you need it the most?

If ever there was a company in need of directors and officers liability insurance, it's Nortel Networks Corp. Such insurance--which pays the millions of dollars in legal fees and penalties associated with a class-action suit, as well as a host of other costs that could bankrupt company managers or directors--has become a must in the post-Enron world. It's protection Nortel desperately needs as the Brampton, Ont.-based technology giant faces police and regulatory investigations in Canada and the United States, as well as class-action lawsuits seeking more than \$3 billion in damages in connection with its much-publicized financial restatements.

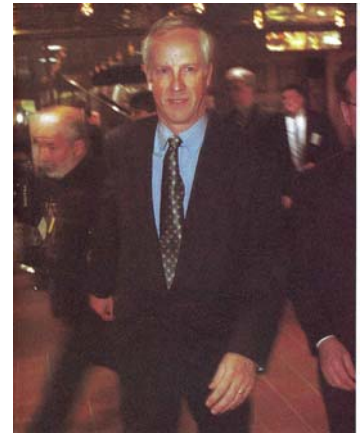
But Nortel isn't just fighting angry shareholders. It's also duking it out with its own insurer, Chubb Insurance Co. of Canada, which attempted to walk away from its coverage of the beleaguered tech firm. According to Nortel's most recent management proxy circular, Chubb informed Nortel it was rescinding a portion of its insurance covering the time of the financial restatements. The insurer tendered US\$1.7 million of the US\$13.6-million premium but later amended its rescission claim and cut that amount to just US\$545,651. Nortel, which would not comment on the dispute, has rejected Chubb's offers and has taken its insurance carrier to court in an attempt to force it to honour the policy. "This is a worst-case scenario," says Elan Pratzer, CEO of Executive Risk Insurance, a Toronto-based company specializing in underwriting directors and officers liability and fiduciary insurance. "You do not want to be arguing with your insurance carrier as you walk up the courthouse steps."

But Nortel is not alone. In the past, insurance carriers have threatened to revoke coverage of infamous companies such as Livent and YBM Magnex. "Threatening to rescind a policy is sometimes used by carriers as a negotiating tool to cut their losses and urge a company to settle more favourably," says Pratzer.

Directors and officers liability insurance policies, called D&Os, are supposed to be a corporate safety blanket to protect managers and directors against the worst boardroom disasters. Without the insurance, managers and directors could be forced to personally pay legal costs and any legal judgments, taxes or penalties levelled against a company. Recent changes to Canadian securities regulations will soon make it easier for shareholders to sue company managers and directors. That makes it even more important for companies to have adequate insurance coverage. But despite paying millions in premiums, many directors may be surprised to learn that policies without a non-rescindable term can be revoked with little or no warning.

Nortel is an extreme example of how the relationship between a company and its insurance carrier can sour. It is also an example of how costly the insurance has become. A Canadian Business survey of liability insurance premiums disclosed in companies' annual proxy circulars, shows that Nortel pays the highest premium in Canada--more than US\$13.8 million for about US\$100 million in coverage. Not only is it the most expensive coverage, Nortel receives the smallest bang for its insurance buck. For every dollar spent by the company, Nortel receives only about US\$7 in coverage. Of the 150 companies we surveyed, the median rate was about US\$100 of coverage for each dollar spent. At the other end of the spectrum is ATCO Ltd., the Calgary-based energy and manufacturing company that pays just \$60,000 for \$175 million in insurance coverage. That works out to about \$2,900 in coverage for each dollar spent.

The figures aren't exactly comparable. After all, how much a firm pays for insurance can vary greatly based on company risk, what the policy covers, the deductible and other factors. But a history of litigation--or run-ins with securities regulators--all but guarantees a company will be paying higher premiums.



With premiums skyrocketing, many companies are looking to reduce those costs by reducing their coverage. By focusing too much on the bottom line, however, those companies may be risking inadequate coverage, says Eric Slavens, a chartered accountant and retired partner with PricewaterhouseCoopers who now sits on three public company boards. For that reason, it is vital that the board of directors takes an active role in picking the company's D&O insurance. "When it comes to choosing insurance, the interests of management and the board may not be completely aligned," says Slavens. "It's easy for management to focus too much on the cost and not enough on the cost-benefit."

Ensuring a company has the right coverage is not as easy as it seems, says Executive Risk's Prutzer. D&O liability insurance is complex, and subtle changes in the policy can make a huge difference to the effectiveness of the coverage. But when presenting the competing insurance options to a company, insurance brokers often boil them down to a simple grid that often fails to highlight important distinctions among the competing insurers. "Unless a director specifically asks probing questions about the different policies, they may not be getting the best coverage," says Prutzer.

THE COST OF PROTECTION				
Company	Ticker	Total insurance coverage*	Total premiums paid	Coverage per dollar spent
HIGH INSURANCE				
Nortel Networks Corp.	NT	\$100	\$13,836,075	\$723
Biovail Corp.	BVF	\$75	\$5,900,000	\$12.71
ATI Technologies Inc.	ATY	\$30	\$2,100,000	\$14.29
Sierra Wireless Inc.	SW	\$25	\$1,700,000	\$14.71
Onex Corp.	OCCX.SV	\$90	\$4,928,500	\$18.26
Barrick Gold Corp.	ABX	\$100	\$4,000,000	\$25.00
Manulife Financial Corp.	MFC	\$150	\$5,900,000	\$25.42
PetroKazakhstan Inc.	PKZ	\$20	\$786,250	\$25.44
Neurochem Inc.	NRM	\$15	\$536,000	\$27.99
Angiotech Pharmaceuticals Inc.	AMP	\$40	\$1,400,000	\$28.57
LOW INSURANCE				
ATCO Ltd.	ACO.NV.X	\$175 ¹	\$60,326 ¹	\$2,900.91 ¹
Canadian Utilities Ltd.	CU.NV	\$175 ¹	\$74,605 ¹	\$2,345.69 ¹
Fraser Papers Inc.	FPS	\$60 ¹	\$42,000 ¹	\$1,428.57 ¹
TVA Group Inc.	TVA.NV.B	\$150	\$108,902	\$1,377.39 ¹
Norbord Inc.	NBD	\$50 ¹	\$42,000 ¹	\$1,190.48 ¹
St. Lawrence Cement Group Inc.	ST.SVA	\$128 ¹	\$118,000 ¹	\$1,084.75 ¹
Aliant Inc.	AIT	\$232 ¹	\$418,230 ¹	\$554.72 ¹
Cogeco Cable Inc.	CCA.SV	\$40 ¹	\$88,000 ¹	\$454.55 ¹
Aur Resources Inc.	AUR	\$20 ¹	\$56,000 ¹	\$3571.4 ¹
Enerflex Systems Ltd.	EFX	\$25 ¹	\$71,200 ¹	\$3511.2 ¹

What every director should know about D&O insurance

- Is the policy irrevocable? Some policies are ironclad and can only be revoked for non-payment of premiums, while others can be rescinded by the insurance company with as little as 90 days' notice. Which kind do you have?
- In case of a lawsuit, will your insurance carrier stick with you to the bitter end? Liability insurance cannot cover fraud. Some policies guarantee to pay defense costs to all company personnel until a court or regulator has determined blame. Other policies allow the insurance company to make that determination near the beginning of the proceedings, and refuse to pay legal costs for directors or managers they determine are at fault.
- Get expert advice. D&O insurance policies can be very complex. Directors should seek independent counsel to ensure they are buying adequate coverage that is appropriate for their company.

Insurance brokers are supposed to be the impartial middlemen between the client and insurance companies competing for their business. But many clients may be unaware of the many compensation and ownership links between brokers and insurance carriers. Those links were the subject of an Eliot Spitzer investigation in the United States that accused insurance companies of paying contingent commissions and other undisclosed payments to brokers to steer business their way. While no illegal business practices have been uncovered in Canada, a report by the Canadian Council of Insurance Regulators released earlier this year expressed concern over this apparent conflict of interest. "Some aspects of the financial relationship between insurance companies and sales intermediaries may give the appearance of bias," the report concluded. Companies looking for the best insurance can also be hobbled by other traditional insurance-industry practices, says Prutzer. Insurance is sold on the basis of risk. But rather than having their individual risk assessed by their insurance carrier, many companies find they are merely slotted into simple, fixed categories based on their size, industry sector and exposure to the U.S. market. Since most of the D&O insurers in Canada are subsidiaries of large foreign companies, their coverage is often based on U.S. risks and formats that are not necessarily applicable to Canada, says Prutzer. "Canada is a unique market with its own unique risks and challenges," he says.

Executive Risk entered the market last year with a different approach. The company--which underwrites coverage on behalf of Lloyd's of London, one of the world's largest insurance underwriters--does an extensive review of the potential client's individual risk profile, including a

detailed assessment of its corporate governance practices. The review goes beyond mere compliance with legal governance requirements and includes background checks on company directors, and an examination of CEO compensation practices and the overall effectiveness of the board. In the past, Prutzer has declined the business of companies that do not meet those rigorous standards.

Ultimately, it is up to the directors and officers of the company to ensure they are getting the best value for their insurance buck. Otherwise, they are faced with the nightmare scenario of finding that they have paid millions for coverage that disappears when they need it the most.

Executive Risk Insurance provides coverage for Directors, Officers and Trustee's Liability and Fiduciary Liability on behalf of certain Lloyds of London underwriting syndicates

