

UNIQUE EXPOSURES

Large Professional Firms, Big EPL Risks

Care needed to place EPL, management coverages for lawyers, accountants

BY PETER R. TAFFAE

PROFESSIONAL FIRMS, SUCH AS LAW FIRMS AND accounting firms, require special attention when placing their executive perils coverages, including employment practices liability and directors and officers liability insurance.

Often agents place these important coverages as if their clients were manufacturers, retailers or other similar commercial risks. Professional firms, however, have numerous exposures that are unique to the service industry and require coverages to match the exposures.

For decades, EPLI, D&O insurance, errors and omissions insurance, and crime policies have been designed for traditional corporations—and the definitions and other clauses are tailored to companies that are incorporated.

Professional firms, however, can often be organized as limited liability corporations (LLCs), general partnerships (GPs) or limited partnerships (LPs). Accountants, law firms and even some insurance brokers are switching to these structures from “S” or “C” corporations (the letters refer to subchapters of the Internal Revenue Code).

Professional firms may change to one of these structures to alter their tax status and maximize their profits, but some firms may also make the change to minimize liability of individuals. (The partners of unincorporated general partnerships, for example, all share equally in liability for legal actions brought against the partnership.)

EPLI policies often insure the directors, officers and the legal entity. Although some policies include “employee” language, it is best to redefine the definition to specifically include “partners.”

Sometimes the definition needs to be even broader to include general partners as well as limited partners. When doing

this, one must be careful not to hinder the coverage by broadening the insured definition so much that it actually heightens

PARTNERS AT RISK

MANAGEMENT LIABILITY CHECKLIST

When placing EPLI for professional firms, such as law firms and accounting firms, agents should seek to:

- ▶ **Broaden the definition** of “employee” in EPLI policies to include “partners”
- ▶ **Be sure to address** the scenario in which a protected class is passed over for partnership.
- ▶ **Take care that limits** are high enough to respond to catastrophic EPL cases that might be brought against firms with seemingly deep pockets.
- ▶ **Include coverage** for third-party discrimination and harassment
- ▶ **Clarify whether the coverage** is sought for situations involving third parties entering the insured’s workplace locations, for the insured’s employees working off-site at client locations, or both.

When placing other types of executive perils coverage for professional firms, agents should:

- ▶ **Consider addressing** D&O risks of partners that sit on outside boards with a master policy.
- ▶ **Address escrow** trust fund exposures in crime/fidelity policies
- ▶ **Recognize the privacy risks** are as real for professional firms as they are for credit card companies and retailers

the exclusionary wording in the “insured-versus-insured exclusion.

Each case is different and often requires a unique approach.

When evaluating coverage for partnership firms in EPL placements, be sure to address the scenario in which a protected class is passed over for partnership. The number of EPL claims for

failure to make partner based on gender and race has substantially increased over the last five-plus years. As you can imagine, these types of claims are expensive and effect the reputations of the insureds.

The allegations may be similar to those that would be brought against a standard commercial insured, such as sexual harassment, wrongful termination and discrimination (based on age, sex, race, disability, etc.) But we can assure you that when accountants, attorneys and other similar professionals bring litigation, it is very expensive and often catastrophic. Often these claims have the added disadvantage of a seasoned plaintiff.

Executives at professional firms are seen as large targets with deep pockets. Sometimes under pressure they underestimate the effect of their actions.

Another example of a specific EPL coverage enhancement that agents should address for their professional firm clients is “third-party” coverage.

We often see proposals or discussions of third-party coverage. However, it is frequently unclear if the proposal is seeking to cover the situation where a third party enters the insured’s workplace and commits an act such as sexual harassment, for example.

Is the third-party coverage intended to cover the situation where a delivery person harasses the receptionist on a drop off? Or does the third-party endorsement cover the insured’s people when working off site, maybe during an

off-site audit at the accounting firm’s client?

These are all important questions to be addressed when placing EPLI coverage for professional firms.

BEYOND EPLI

When considering D&O insurance for partnerships, agents need to keep in mind

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BIG EPL RISKS

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that partners are often sitting on their clients' boards or other outside boards.

A master policy for all partners who sit on other boards—be it public, private and not-for-profit boards—would provide the benefit of extra protection through a policy tailored to their unique exposures. Do not think that placing a traditional D&O policy on a law, accounting or other professional firm is truly addressing all their needs, and most important protecting the partners when they serve in these other capacities.

Turning to fidelity and crime coverages, we note that most ISO forms (developed by the Insurance Services Office) do not specifically provide coverage for fraud and dishonesty of partners.

This might not be seen as a real threat in a small firm, but as the number of partners grows and they spread to numerous locations, the need for partner coverage increases.

Also often overlooked are the funds being held in escrow at professional firms. Can you imagine if the clients' funds in the insured's trust account were compromised?

Often the magnitude of just the loss of client funds, let alone the insured's assets will cause a firm to close.

We often review insurance policies for escrow agents that are not addressing their "trust" exposure. Lawyers, accountants, insurance agents and other professionals are no different.

PRIVACY ISSUES

In addition to unique EPLI exposures of partnerships and unforeseen management liability risks, professional firms have large and potentially devastating exposure to breaches of privacy, yet many have no recognition of the necessity of this insurance coverage.

Professional firms that are not purchasing privacy insurance coverage may just not know it is available. Still, it is hard to think of a professional firm that has not accumulated an abundance of "personal data" as defined by the laws of 44 states and federal law as well.

For other types of commercial firms, mega-claims like breaches disclosed by organizations that regularly handle per-

sonal data, like ChoicePoint and CardSystems (a credit card processor), and even retailers like Hannaford (a supermarket chain involved in a 2008 computer systems' breach exposing more than four million credit card numbers) have already shown the need for this coverage.

Although cyber liability insurance has been around since the late 1990s, it has been only the last 18-to-24 months that the insurance industry has enhanced and focused on the privacy perils.

The insurance market for privacy coverage today is similar to the EPLI market of the early 1990s, when EPLI was first introduced. It is an exciting but confusing time to many. Each insurance company offering this coverage is taking a different approach and has its own policy language.

The basic coverage triggers, however, can be summarized as follows:

- **A failure of your network** security protections
- **A failure to protect** or wrongful disclosure of private or confidential information
- **A failure to protect** personally identifiable information (PII) from misuse or theft
- **A violation of any** federal, state or local privacy statute alleged in connection with the failure to protect PII

The costs associated with privacy breaches are not only first-party costs, but also third-party damages, which are often even greater than first-party expenses. Class-action lawsuits have been and continue to be frequent consequences of privacy breaches.

Coverage provided by a comprehensive privacy policy would include, but not be limited to coverage for:

- **Third-party** damages and legal claims
- **Fines and penalties** imposed by federal, state and local governments
- **Expenses incurred** in notifying customers of a breach, and the cost of mitigating reputational damage done
- **Defense costs** within policy limits
- **Expenses incurred** repairing or cleaning up the breach
- **Fines levied** by banks and credit card companies due to a privacy breach

When insuring a professional firm, an example of an issue that needs to be considered to ensure the broadest coverage is obtained is the question of whether the

scope of coverage includes all "leaks" or just unauthorized breaches.

The attorney or accountant that leaves his or her laptop at Transportation Security Administration at JFK airport or LAX might need the coverage, but that activity might not fall within the scope of an unauthorized breach.

Costs associated with complying with each state's requirements and fulfilling the breach notification require-



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ments of the 44 states that have passed privacy laws range from \$55 to \$206 for each client, according to numerous industry experts. (Editor's Note: For example, Ponemon Institute, a Traverse City, Mich.-based privacy and information management firm, said that direct costs per customer were \$50 in 2008 and total costs were \$202 per customer, rising to \$204 per compromised customer in 2009.)

Unless the professional firm is a young firm, the number of past and present clients can easily run into the tens of thousands.

Privacy claims are expensive, and if not addressed quickly, correctly and fairly can destroy a professional services firm whose reputation is built mainly on trust.

When seeking coverage for professional firms it is important to understand their special needs and match those needs with the best insurance products available. Although sometimes challenging, it is important for agents and brokers to recognize this as an opportunity to differentiate themselves from competitors and to bring their clients the value-added protection they rightfully deserve. ■■

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