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D&O NOTEBOOK

Basic Insurance for Start-up Companies

By Wade Pederson (Guest Blogger)

> *At Woodruff-Sawyer we work primarily with public companies and large private companies. Companies generally first start working with us when they have something to lose. For most companies this is the Series C/Series D round of funding, the 50-75 employee threshold, or $50 million to $75 million in revenue. Of course the metrics differ for life sciences companies. Having said that, there's a real need for start-ups to have a sense of the basic insurance they need right out of the gate.*
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> *To address this need my colleague Wade Pederson has written a guest post designed to help start-up companies understand their basic insurance needs. Wade is an expert in property & casualty insurance for fast-growing companies, including large international companies.*
>
> *— Priya Cherian Huskins*

Cash is usually king for start-up companies, and there's no point in over-buying insurance. Some insurance, however, is either required or prudent. Below is a 5-point framework to help start-up companies take a first step in determining what insurance they need at an early stage.

1. Buy Insurance When It's the Law

Certain coverages like Workers' Compensation or Auto Liability for owned vehicles are statutorily required in nearly every state. Other insurance required by jurisdiction will vary by industry such as clinical trial insurance for sponsor companies. If you have a New York office or employee, make sure that mandatory Disability insurance is in place. You'll want to work with your trusted advisors—your lawyer and/or your insurance broker—to understand the insurance requirements in each state (or, where relevant, country) where you may do business or have an office.

2. Buy Insurance to Comply with Contract Requirements

Do you want to sign a lease? Enter into an agreement with a prospective customer? Sign up with a Preferred Employer Organization (Trinet or similar)? These and many other types of business contracts will require that you maintain basic commercial insurance including Commercial General Liability ("CGL") insurance. Along with legal review, you will want your trusted insurance broker to review the details of insurance and indemnification provision in all the contracts you sign.

(continued on page 2)

3. Buy Insurance to Transfer Catastrophic Risk Away from Your Balance Sheet

A catastrophic, multi-million dollar claim, while never anticipated, can strangle a start-up company all too quickly. For example, a calamitous auto accident involving an employee on work assignment and major injuries to third parties could create significant legal costs for a company without proper insurance.

Should you manufacture, distribute or sell consumer goods you may be exposed to consumer or class action lawsuits alleging harm caused by a defective product. This would generally fall into the category of Products Liability insurance and is included in the typical General Liability policy. Critically, the insurer would have an obligation to fund your defense, even for baseless or frivolous suits.

Finally, the basic Auto and General Liability insurance policies provide $1,000,000 of insurance. It usually makes sense to top this off with an Umbrella policy that provides an additional layer of protection in an amount of your choosing.

4. Buy Insurance to Address Operationally-Specific Risks

Companies with unique operational exposures, such as use of hazardous chemicals, will want tailored insurance contemplating the risk of environmental damage, for example. Life Sciences companies are another example of a type of company that might have some industry-specific insurance even at a relatively early stage.

Most businesses will accumulate some quantity of sensitive information they have an obligation to protect, even if only about the company's own employees. Cyber insurance can address the risks associated with the financial impact of a data breach event. Cyber insurance will be even more important if your business is consumer or health-care focused.

5. Buy Insurance if M&A Might be Your Exit Strategy

If M&A could be in your plans, expect that your potential buyers will want to see as part of their diligence that you have put in place a basic insurance program with adequate limits. For coverages such as Errors & Omissions/Cyber Liability or Products Liability for a biotechnology company, an acquiring company will want to be assured so called "tail" insurance will respond if there is a claim that arises after the deal closes. A tail holds a policy open for a period of time after the deal closes, allowing the buyer to keep in place insurance for a future claim that might not covered elsewhere.

As your company grows, you will of course want to improve the sophistication of your insurance risk management program. Director and officer liability insurance,[1] employment practices liability insurance and fiduciary liability insurance are among the lines of "Management Liability Insurance" that companies often put in place sooner than later. A competent insurance broker who specializes in working with start-up companies can help understand when to implement these and other types of insurance at a pace that is commensurate with the needs of your growing company.

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[1] https://wsandco.com/do-notebook/priv-comp-do-guide/

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Wade Pederson can be reached at 415.399.6354 or wpederson@wsandco.com.

Priya Cherian Huskins can be reached at 415.402.6527 or phuskins@wsandco.com.