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## OUTSIDE COUNSEL

BY RICHARD A. FOGEL

### *Risk Management for Small Businesses*

Every business has risk by nature, and managing that risk is part of managing a business. Unfortunately, lawsuits and claims are part of being a success. Plaintiffs do not usually bother businesses that are failing. Thus, a well-run business is prepared to manage its risk so that the future of the business is well protected.

There are two types of risk: business related and non-business related. Business related risk includes product (or service) failure, vendor error, competition and product (or service) liability. Non-business related risk include natural disasters, fire, power loss and general negligence not arising out of a product or service.

Both categories of risk may be partially controlled by utilizing a combination of insurance products and preventative business practices. Neither tool is completely fool proof, but understanding the tools and how to determine a business' needs goes to the heart of good management.

#### **Insurance Risk Management**

Too many small business managers do not understand their insurance. Worse, they use an inappropriate or inexperienced broker who does not know commercial insurance.

An agent who sells personal auto and homeowners insurance is not a commercial expert. He may sell commercial insurance policies, but chances are he will not provide the most appropriate coverage. A professional commercial insurance broker should be used, and business operations should be reviewed annually with a broker, an accountant and legal counsel. This is the only way to assure that business needs are understood and that the most current insurance products are accessible.

Property insurance covers for losses to property, including fire. Special coverage is needed for the risk of damage from floods, wind, environmental contamination, terrorism, radioactivity and business interruption.

Liability insurance covers businesses for liability to others arising from fortuitous incidents: i.e. "accidents" and the legal costs associated with them. Liability insurance does not cover a liability to others arising from business disputes: i.e. breach of contract, warranty, or replacement of product or service.

The basic commercial liability policy does not include coverage for claims arising out of defective products or services. Since every business makes a product or provides a service (or both), businesses require this coverage in addition to the most basic commercial liability coverage. Insurance also is required for workers' com-



pensation, which is a separate policy, and commercial auto coverage, also a separate policy.

The specialty insurance market for both property and liability risks is always evolving and there is a broad list of additional coverages available should a particular business require them. The most common specialty insurance products used by businesses today pertain to liability and include coverage for risks arising from discrimination, wrongful acts, environmental contamination, lead paint, asbestos, directors and officers liability, and extraterritorial (outside the United States) liability.

A business may not be able to afford all the potential coverages, but should be informed on the cost, risks and availability of the different products. Then a management decision can be made on what is best for the company and whether to take steps to manage the risk that does not involve purchasing insurance.

Other aspects of insurance that should be discussed each year are the deductible or self-insured retention, claims procedures, proof of insurance by the company and its vendors, indemnity for landlords or customers, and umbrella and excess coverage. Business owners should be educated about how to make a claim and be aware that notice of a claim to the broker is not notice to the insurance company.

A commonly requested endorsement requires that management be aware of a claim against the company and not just any employee or agent of the company.

Indemnity limits should be realistic and not the bare minimum. Courts in the New York area commonly award damages in amounts up to \$10 million, so a \$1 million indemnity limit is going to put a company at jeopardy.

Maintain insurance contracts, even after they expire. Many types of insurance have "long tails," which means that they may be applicable to a particular claim long after the policy has expired.

Do not assume the broker or the insurance company will have a record of the policy. Also, ask for complete copies of the policies and not just the declarations page, the binder and the endorsements. A full copy of the contract with all the terms and conditions of coverage should be retained by the business.

#### **Defensive Risk Management**

Managing business risks by utilizing such tools as contractual clauses, pro-active defensive measures such as disaster back-up and recovery and preventative business practices such as inspections, warnings and training is very effective and cost efficient. This is the type of risk management that is probably already practiced with-

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Continued from page 4

out even realizing it. Taking the time to annually review these practices with a professional team and formalizing the process will provide additional protection.

Utilize a standard written agreement signed by the customer or vendor before the products/services are rendered. Limit liability and express and implied warranties. If a product/service may give rise to certain known or potential risks (i.e. the network may crash, other software may not work etc.) draft a written informed waiver agreement that explains these risks and advises the client that the business is not responsible for these risks.

Ask the client to separately sign the waiver agreement and attach it to the standard written contract that the customer also must sign. Written indemnity agreements should also be signed before the product or service is rendered.

Require vendors to provide written proof of insurance by a certificate of insurance issued to the company by the insurer which sets forth the

required coverages and the additional insured provision. Make sure that the required insurance has realistic indemnity limits. The certificates should be provided before the product/service is rendered.

#### Legal Review

Legal counsel should review business forms annually. It is cheaper to prevent a risk problem than it is to resolve a claim. Counsel and the rest of a professional team should be advised if a business changes and adds new products or services.

Written agreements with employees can also control certain types of risk that may be applicable to a business. Courts increasingly are willing to enforce reasonable non-compete agreements and confidentiality agreements. These should also be annually reviewed by counsel.

Proactive risk management traditionally encompasses inspections and training. Most firms today also draft a written company manual that includes all the important risk and management policies of the company, including statements that discrimination will not be tolerated.

Offsite storage of written file and hard drive storage/back-up and other disaster recovery plans can save a business as it did with many of the complex businesses whose offices were destroyed in the World Trade Center. Diversify suppliers of telephone lines, electricity (i.e. a back up

generator) and other vendors of critical supplies if a business is particularly dependent on these services or "just in time" delivery.

Claims handling is another proactive tool that can be critical, particularly if there are several business locations, a business deals with the public or its employees are often off-site.

Utilize a standard written claim report, included in a policy manual, that requires witness identification, photos at the time of the incident, insurance notice, executive notice, professional notice and witness statements.

The form should explicitly advise all employees to maintain all evidence so a company is not accused of spoliating evidence. This legal doctrine could make a company liable even if it did not do anything wrong.

Tag all relevant materials (e.g. the defective hard drive, broken chair, written records, etc.) and preserve them indefinitely so that they are not thrown away until the claim is resolved. Advise employees where to send all this material.

Early intervention in a claim by settlement is very effective at resolving claims. A reasonable customer who is upset may be mollified by personal attention and a future discount.

Risk management is a cost-effective part of managing a successful business. Formalizing a professional approach to risk management will ensure continued success.

Daily columns in the *Law Journal* report developments in laws affecting medical malpractice, immigration, equal employment opportunity, pensions, personal-injury claims, communications and many other areas.