



D&O Liability Addendum to Coronavirus (COVID-19) FAQ of March 5

March 20, 2020

Key, salient points about our Executive & Professional Risk Solutions (EPS) lines were addressed in our March 5th FAQ. Since then, there have been additional developments, particularly regarding Directors & Officers (D&O).

Q: Has there been, and will there be, D&O litigation because of this pandemic?

A: While the majority of companies will be impacted negatively, there will be some that suffer outsized damage based mostly on their industry and their financial strength (or lack thereof) to deal with this event.

Already, we have seen shareholders file securities class actions against two (2) companies and executives:

- Norwegian Cruise Line Holdings, Ltd.
- Inovio Pharmaceuticals, Inc.

These likely won't be the only lawsuits – for public companies, private or not-for-profit (NFP) organizations. In the early days of this crisis, the plaintiffs' bar may cut companies a break while the world deals with the pandemic, but as things get back to normal, certain companies may enter the crosshairs. And given the global nature of this crisis, both U.S. companies and non-U.S. companies could face claims. For any organizations that file for bankruptcy protection, whether public, private or NFP organizations, D&O litigation could ensue.

Q: Since March 5th, what new D&O issues have evolved for public and private companies?

A: Public companies – The Securities & Exchange Commission (SEC) has advised all public companies to

assess what the Coronavirus means for their future operations and financial results and to make appropriate disclosures to their shareholders and other members of the investment community. The SEC cautioned that, because estimates of the extent and severity of the Coronavirus are rapidly evolving, public companies, and particularly their boards of directors and disclosure professionals, must be constantly attentive to the need to modify their thinking, and possibly their SEC and investor disclosures, in light of the latest developments. This is an ongoing directive and thus challenging.

Further, SEC staff have provided guidance to promote continued shareholder engagement, including at virtual annual meetings, for companies and funds affected by COVID-19. The following link brings you to SEC commentary on the Coronavirus:
<https://www.sec.gov/news/press-release/2020-62>

Private companies and NFP organizations – It is not just public companies that may face increased exposures. While privately held companies and NFPs do not face the same level of disclosure obligations, they do face the same exposure to deteriorating economic conditions and thus negative financial impacts, including potential bankruptcy.

Overall, any financial strains placed on businesses (or NFPs) could result in contentious disputes with creditors, minority shareholders, customers, regulators, competitors, suppliers, vendors, donors, employees or others. D&O litigation against any type of organization and its leaders can stem from any/all of these relationships.

Q: How will D&O liability risks and D&O underwriting be affected?

A: Increased disclosure risks for publicly traded companies – Potential plaintiffs may ask:

- Were a company's past disclosures, before this crisis escalated, adequate for investors?
- In light of the SEC comments, are the real-time disclosures for the risks of today and tomorrow accurate and adequate? It is clear that NOT speaking up in the face of a material risk escalation will not be looked kindly on by SEC enforcement officials, investors and D&O underwriters.
- In making disclosures, were there any violations of Regulation FD (Fair Disclosure)? This regulation restricts selective disclosures of any material nonpublic information and requires an issuer to disclose the information to all if they chose to disclose to certain individuals or entities (like stock analysts).
- Was there any insider trading activity that could be deemed suspicious?

Heightened mismanagement risk for public, private and NFP organizations – Again, derivative claims could allege mismanagement of, or failure to manage, the exposure of the Coronavirus.

Bankruptcy risk – In the wake of the Coronavirus fallout, some weaker organizations could succumb to the financial pressures, forcing a bankruptcy filing. Some of the largest private company D&O losses have stemmed from bankruptcy filings and contested resolutions – reorganizations and liquidations, i.e.

Business-to-business (B2B) disruption and dispute risk – Given the inter-reliance of vendors/suppliers/merchants, major disruptions could mean major litigation. Importantly, this could impact privately held companies (and their D&O coverage) as much as, or more than, public companies.

While all these increased risks are worth watching, they don't necessarily guarantee D&O litigation will spike significantly.

But we do anticipate that, at the very least:

- Coronavirus D&O underwriting questions – For Insureds to answer, with deeper scrutiny of the industries listed previously. And, if answers do not satisfy underwriters, Coronavirus exclusions may be added.
- Coronavirus (or COVID-19) specific exclusions – If any carrier quotes this type of exclusion, either absolutely or subject to underwriting questions, contact your D&O professional immediately as the implications and options need to be discussed.
- A continued hardening of the D&O market – Increased pricing, higher retentions, more risk-sharing and less limits offered on many placements with the Coronavirus a new and added source of considerable concern for insurers.

Q: What current coverage issues should all companies (public, private and not-for-profit (NFP) companies place their focus on?

A: Any bodily injury (typically includes sickness, disease, or death, and can include mental anguish, emotional distress and invasion of privacy-type wording) exclusion –

- Does it have “for” lead-in language, which is more desirable than a “based upon, arising out of...” preamble?
- Does it have a Securities Claim carveout (meaning that the exclusion does not apply to shareholder-type claims)?
- If any excess Side A difference in conditions (DIC) coverage exists, there should be no bodily injury exclusion at all.

Pollution/environmental exclusion – Similar to the bodily injury exclusion, are there carve-backs for Securities Claims and/or any Side A losses.

Private company/NFP specific coverage issues –

- Breach of contract exclusion – Typically, this type of exclusion will exist on a private

company/NFP-specific D&O policy. Business interruptions and event cancellations will almost certainly result in business-related disputes amongst vendors/suppliers/others. Is the contract exclusion “absolute,” meaning that it applies to ALL insuring clauses, including the coverage for individual D&Os? Or does it just apply to the organization’s potential liability?

- Anti-trust/competition exclusion – Typically, this type of exclusion will exist on a private company-/NFP-specific D&O policy. Many anti-trust exclusions on D&O policies exclude coverage for allegations of “unfair trade practices,” a common charge in business-related claims and an area where D&O underwriters have already imposed restrictions for certain industries.
- Dedicated Side A coverage – Most private company D&O forms have some level of dedicated Side A coverage, but compared to public companies, the proportion of Side A only coverage to full, shared coverage (D&Os and the organization) can be low.
- Overall entity coverage limitation – For large private companies (\$1B+ in annual revenues), has the D&O “entity coverage” been limited to cover only shareholder/securities claims (an increasing trend in the last year)?
- Fraud exclusions – These exclusions should only apply when there is proven, finally adjudicated fraud on behalf of the insured, and full severability of the type exclusions should exist to protect innocent insureds.
- Professional services (E&O) and products liability exclusions – These can apply to all types of organizations but typically target certain industries with clear service exposures. These can impose restrictions on D&O coverage unless certain carve-backs (for securities claims and/or failure to supervise, i.e.) exist. Any Side A-only policies should not have this type of exclusion at all.

Aside from a **Coronavirus or COVID-19-specific exclusion being added** or the lack of appropriate carve-backs noted above, the existence of other typical exclusions on a D&O policy should not cause alarm, but understanding the nature of how that exclusion applies is critical.

Questions to consider:

- Which insureds does the exclusion apply to? Does it apply to claims against the insured organization only, or also to claims against individual insureds (D&Os)? And if it applies to claims against individual D&Os, will it apply in the absence of indemnification of the organization (known as Side A loss)?
- Does the exclusion apply to defense costs as well as to any judgements or settlements?

Conclusion

There are more questions than answers about the correlation of the Coronavirus pandemic and D&O litigation, but anticipating potential underwriting process disruption, potential claims and potential policy responses can help Insureds have more clarity about how their risk transfer programs may respond today and in the future.

For additional information, please reach out to your USI representative.

Helpful Resources

For additional resources, tools, information, and links, please visit our **Coronavirus (COVID-19) page**:

www.usi.com/public-health-emergencies