

How To Navigate A Hardening D&O Insurance Market

By **Brian Scarbrough, Caroline Meneau and Huiyi Chen** (October 6, 2020, 3:51 PM EDT)

After more than a decade of being in a soft market, directors and officers liability insurance entered into a hard market in 2019. What already would have been a less favorable market for insurance buyers has been further hardened by the global pandemic — premiums soared 16.8% in the second quarter of this year according to a Council of Insurance Agents & Brokers report.[1]

Coupled with the hardening of the D&O liability insurance market is the potential surge of lawsuits against companies and their directors and officers as a result of the economic fallout from the coronavirus.

As directors and officers make critical decisions in an unpredictable era, companies should take a close look at their D&O liability insurance program to try to put in place as much as possible a soft landing for corporate management in a hard market.

Litigation Risks Directors And Officers Face in the Pandemic Era

Directors and officers of public and private companies face the potential for a variety of lawsuits related to the collateral damage and economic fallout due to the coronavirus and the pandemic response.

These lawsuits range from securities class actions or derivative lawsuits alleging COVID-19-related misrepresentation or failure to disclose risk factors, to claims brought by trustees or creditors in bankruptcies during the economic downturn, to claims of mismanagement in the aftermath of data breaches in the work-from-home environment, just to name a few.

In the area of securities class actions, for example, the Stanford Law School Securities Class Action Clearinghouse tracked 16 cases filed since the beginning of the pandemic,[2] and, not surprisingly, all of them included the directors and officers as individual defendants.

These complaints involve pharmaceutical companies that allegedly made false statements in U.S. Securities and Exchange Commission filings regarding the development of coronavirus vaccine, testing or treatment,[3] exchange-traded funds tracking crude oil prices that allegedly failed to disclose the



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effects of the COVID-19 pandemic on crude oil demands,[4] and travel companies that allegedly misled investors on adherence to health and safety protocols,[5] among others.

Also notable is another wave of shareholders derivative litigation against directors and officers alleging lack of diversity on the companies' board of directors.[6] The companies involved so far are some of the biggest names in the technology industry, and there is reason to believe such lawsuits will only grow and expand in the midst of the ongoing social justice movement during the pandemic era.

Although these lawsuits have not yet appeared in large numbers, and the overall impact remains to be seen, the broad variety of companies and industries that have already been sued shows the unpredictability of pandemic-related litigation risks that business leaders need to be aware of — especially as they may show up as co-defendants in these types of cases.

In addition to class actions or derivative lawsuits brought by shareholders, companies and their directors and officers may also be exposed to regulators' increasing investigation and enforcement actions, as the SEC "is monitoring how companies are reporting the effects and risks of COVID-19 on their businesses, financial condition, and results of operations." [7]

A recent example is that the SEC brought an enforcement action against the president of a biotechnology company on claims of false statements concerning "the status of the development of [the company's] COVID-19 tests." [8]

As companies prepare to file quarterly or annual reports with no end to the pandemic in sight, the securities litigation risks — shareholder class actions or derivative actions alike — that directors and officers may face are on the rise. As discussed below, it is critical for companies to carefully and strategically review their existing D&O liability insurance coverage to identify any gaps or other issues and be prepared to address them now proactively or during placement or renewal.

Another area where directors and officers might face individual liability for their management roles is trustee and creditor claims in bankruptcy proceedings. According to the statistics on the American Bankruptcy Institute's website, there have been 4,780 Chapter 11 bankruptcy filings through August of this year, which is an increase of 1,052 filings or 28% year to date.[9]

In many jurisdictions, directors and officers owe a fiduciary duty to creditors to maintain assets once the company files for bankruptcy. Creditors of a company in bankruptcy thus may have standing to bring derivative lawsuits against directors and officers.

In a recent U.S. Court of Appeals for the Third Circuit decision, the court held in *Artesanias Hacienda Real SA De CV v. North Mill Capital LLC* that the plaintiff creditor "has both constitutional standing and the statutory authority" to pursue asset-plundering claims after the trustee of the bankruptcy estate abandons the same claims.[10]

Directors and officers may be vulnerable to lawsuits if the company has to file for bankruptcy in the current economic downturn, and should carefully examine the bankruptcy provisions of their D&O liability insurance policies and be alert to any regulatory exclusions or insolvency or bankruptcy exclusions or creditors' claims exclusions.[11]

Particular policy language to focus on includes any insurer versus insured or entity versus insured exclusion to ensure there are adequate carve backs for claims brought in bankruptcy, any change in

control provisions that might be triggered in bankruptcy, and any extended reporting period options, should an insurer nonrenew the policy given bankruptcy.

Having side-A-only D&O liability insurance policies that protect only the individual insureds and not the company also are important in bankruptcy, as such policies offer dedicated protection to individuals and should avoid an issue of being considered property of the bankruptcy estate.

Finally, the work-from-home norm prevailing in a large part of the economy may increase the risk of cyberattacks or hacking leading to the breach or theft of data stored by companies that belong to individual consumers or employees.

The losses suffered as a consequence of these data breaches and thefts may lead to securities lawsuits against directors and officers on claims of mismanagement. This adds to the trend of rising cyber-related litigation that already was taking place before the pandemic and creates additional risks directors and officers face in managing companies.

A summary chart comparing the number of lawsuits filed in various areas against directors and officers in U.S. federal courts for the past three years is below.[12]

Type of Lawsuit (U.S. Federal Courts Filing Only)	2020 (As of Oct. 1, 2020)	2020 Pandemic-Related (As of Oct. 1, 2020)	2019	2018
Number of securities lawsuits filed against Ds&Os alleging misrepresentation or failure to disclose	344	63	473	329
Number of securities lawsuits filed against Ds&Os involving data breach or cyber incidents	2	1	19	27
Number of securities lawsuits filed against Ds&Os for lack of diversity on the Board of Directors	11	0	0	0

Mitigating Risks by Reexamining Your Current D&O Liability Insurance Coverage

As various pandemic-related lawsuits against companies and their directors and officers are only at the beginning stage, it is not yet clear how insurers will respond to coverage claims under directors and officers policies, or what disputes will be the subject of coverage lawsuits.

While D&O liability insurers do not appear to be rushing to add pandemic or virus exclusions to insurance policies, vigilance is required during renewal or placement to ensure no such exclusions appear.

It is critical for companies to reexamine their current D&O liability insurance coverage to identify any

gaps — assuming they already have such policies or risk management structure in place — in order to mitigate risks directors and officers will face personally in the years to come.

Corporate leaders are making important business decisions on a daily basis in an unprecedented and volatile era, and companies should provide them with reasonable protection through a robust D&O liability insurance program.

For example, companies should evaluate (this is not an exhaustive list):

- The policy definition of "claim" — broader definitions that include all types of legal proceedings and demands, including subpoenas, are preferred but also bring with them a need to understand when notice of such a claim needs to be made to the insurer;
- The policy definition of "insured" — to make sure the policy covers everyone the company intends to protect;
- The policy definition of "loss" — to make sure a broad definition includes many types of damages or relief, including punitive and exemplary damages to the maximum extent allowed by applicable law;
- The policy definition of "wrongful act,";
- The insurer's level of control over choice of defense counsel and settlement;
- The presence of exclusions for culpable conduct such as fraud, and whether this is a final adjudication requirement;
- Any priority of payment provisions that ensure individuals receive heightened protection;
- Any allocation provisions dealing with how to treat mixed claims that present both covered and uncovered loss;
- The level of coverage available for bankruptcy-related claims (as previously discussed);
- The presence of broad imputation provisions that prohibit the knowledge or wrongful acts of one insured to be imputed to another insured, including as to all policy exclusions;
- The presence of any broad pollution exclusion — if an exclusion is present, does it expressly carve back coverage for securities claims and other types of claims; if an exclusion is not present, how does the definition of "loss" address pollutants; and
- The presence of any special exclusions that may limit coverage.

It may not be easy to place or renew a robust D&O liability insurance program in the current hard market, a situation companies began facing even before the pandemic.

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[1] The Council of Insurance Agents & Brokers, Commercial Property/CasualtyMarket Report Q2 2020 (April 1 – June 30), <https://www.ciab.com/download/25836/>.

[2] See <http://securities.stanford.edu/current-topics.html> (under the "COVID-19" Tag). Some commentators have tracked more. See, e.g., Kevin LaCroix, Kodak Hit With Securities Suit Over COVID-19-Related Loan Disclosure and Related Trading, the D&O Diary Blog (Aug. 16, 2020), <https://www.dandodiary.com/2020/08/articles/coronavirus/kodak-hit-with-securities-suit-over-covid-19-related-loan-disclosure-and-related-trading/>.

[3] See, e.g., Complaint, Himmelberg v. Vaxart, Inc., No. 3:20-cv-05949-VC (N.D. Cal. Aug. 24, 2020).

[4] See, e.g., Complaint, Lucas v. U.S. Oil Fund, LP, No. 1:20-cv-04740-PGG (S.D.N.Y. June 19, 2020).

[5] See, e.g., Complaint, Serv. Lamp Corp. Profit Sharing Plan v. Carnival Corp., No. 1:20-cv-22202-KMM (S.D. Fla. May 27, 2020).

[6] See, e.g., Complaint, Kiger v. Mollenkopf, No. 3:20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020) (Qualcomm derivative lawsuit).

[7] See SEC, Division of Corporation Finance, CF Disclosure Guidance: Topic No. 9, SEC Website (March 25, 2020), <https://www.sec.gov/corpfm/coronavirus-covid-19>.

[8] Complaint, SEC v. Schena, No. 5:20-cv-06717 (N.D. Cal. Sept. 25, 2020).

[9] Statistics from Epiq, August 2020 Bankruptcy Statistics – Commercial Filings, American Bankruptcy Institute Website, <https://www.abi.org/newsroom/bankruptcy-statistics>.

[10] See Artesanias Hacienda Real S.A. De C.V. v. North Mill Capital, LLC (In re Wilton Armetale, Inc.), No. 19-2907 (3d Cir. Aug. 4, 2020).

[11] See, e.g., Kevin LaCroix, A Current Hot D&O Insurance Question: Are Bankruptcy Exclusions Enforceable?, the D&O Diary Blog (June 7, 2020), <https://www.dandodiary.com/2020/06/articles/d-o-insurance/a-current-hot-do-insurance-question-are-bankruptcy-exclusions-enforceable/>.

[12] The authors would like to thank James Walsh, Research Librarian at Jenner & Block LLP, for his contribution to the research. "Securities lawsuits" include shareholder class action, shareholder derivative lawsuits, and other securities lawsuits brought by individual shareholders. The numbers in the chart are results based on keyword searches in the Bloomberg Law Dockets and are only estimates.