

The Impact of COVID-19 on Private Company Directors & Officers Liability Insurance

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The human and economic impact of COVID-19 continues to unfold and evolve. This is forcing business owners and executives to navigate their companies through uncharted waters. The economic disruption created by the pandemic will inevitably lead to lawsuits against businesses, and directors and officers liability (D&O) insurance will come into play.

D&O policies for private companies typically provide broad coverage for the company, as opposed to public company D&O policies that only cover the company's liability for securities claims. This coverage could help cover the costs of lawsuits arising from the COVID-19 pandemic.

Private company lawsuits in the wake of COVID-19

Lawsuits have already emerged from the economic impact of COVID-19. Examples include:

- A lender declared a default based on a material adverse change (MAC) in the borrower's business based on the economic impact from COVID-19. The borrower filed for bankruptcy and immediately sued the lender in an adversary proceeding asserting the contract did not permit a MAC declaration based upon COVID-19. The breach of contract cause of action may be excluded under the policy, but the borrower also alleged the lender made fraudulent misrepresentations, and that claim may trigger coverage.
- A mortgage company closed on loans but was thereafter unable to fund the loans because of an unexpected lack of liquidity. Borrowers sued alleging breach of contract and fraud. Similarly, the breach of contract claim may not be covered, but the fraud allegations may require the D&O policy to cover some of the lawsuit.

Other claims that may arise include:

- Contract disputes over nonperformance based on force majeure provisions. Companies unable to perform based on supply chain disruptions or unavailability of employees have declared contracts voidable based on these provisions. Lawsuits in these scenarios could impact both D&O and professional liability policies, and allegations of fraud or misstatements could trigger coverage.
- Shareholders, investors and others negatively impacted by financial restructuring may assert claims for breaches of fiduciary duties in how executives planned for, and responded to, the COVID-19 crisis. D&O policies should respond to such claims.
- The massive government lending programs enacted in response to the pandemic will eventually lead to scrutiny as the economy recovers, which may bring investigations and lawsuits by the government in the administration and access to those programs. D&O policies may provide coverage for such actions, although investigations present coverage challenges.

Private company D&O coverage issues

Coverage under D&O policies for claims arising from COVID-19 will be scrutinized closely. Insurers will focus on these exclusions that are typical in private company D&O policies:

- Bodily injury and property damage exclusion: Claims brought by employees or others who become sick should fall under workers' compensation or general liability policies. D&O insurers may balk at covering such claims using this exclusion, but companies should push for coverage if claims seek damages beyond personal injuries (e.g., negligent supervision), or breach of fiduciary duties.
- Pollution exclusions: Claims arising from alleged COVID-19 infection may cause insurers to invoke the pollution exclusion. This will be fact-specific, but companies should resist most attempts by insurers to do so as this does not appear to be the intent of that exclusion on D&O policies.
- Breach of contract exclusion: This exclusion typically applies only to claims against the company, as opposed to individuals, and insurers will be quick to deny coverage for claims arising from contractual obligations. Look for other allegations to trigger coverage such as fraud or misrepresentation.
- Professional service exclusion: For claims that a company failed to provide products or services, the professional services exclusion might apply. Look for coverage under errors and omissions policies, as well as additional allegations that may trigger coverage.

Companies should review potential crisis management coverage. The COVID-19 pandemic may fall under the definition of "crisis management event" that triggers coverage for legal and public relations costs responding to such an event. While this coverage is typically limited, it is worth exploring.

D&O renewals will be challenging – Prepare for a shifting landscape that may get worse

COVID-19 is having a significant impact on the D&O insurance market, which was turbulent before the pandemic began. In order to obtain the best possible result for your D&O renewal, begin planning now with your broker and legal advisors. Current D&O market conditions include:

- Underwriting decisions must be reviewed by upper level management, slowing down the process and requiring an earlier than normal process.
- Expanded inquiries into the impact of COVID-19 on businesses, including revenue expectations, liquidity and long-term financing plans, debt maturities and covenant exposure, potential supply chains disruptions, and board of director response and involvement.
- Focus is on closely reviewing renewals; insurers have been less interested in new business submissions and are skeptical of first-time buyers – assumption is there are problems.

Underwriters – like all of us – don't yet know the scope of the economic disruption. This is driving conservative decisions, and underwriters are managing capacity and reviewing overall exposure particularly with larger towers.



What to do now

When your company begins to plan for recovery and growth, give careful consideration to the D&O renewal process. While we don't know how long the economic downturn will last, there are steps you can take to be in the best position moving forward.

If your renewal is coming up, make every effort to avoid extending the expiration date. The next 90-120 days will allow underwriters to assess potential claims status of current accounts. Carriers will have more information on which to base decisions – and it appears it may be negative. This may result in fewer options and more onerous terms.

Begin the renewal process earlier and be prepared to provide more information than normal. Brokers may have to market to multiple carriers and negotiate extensively. Insurers may consider adding exclusions for claims related to or arising out of COVID-19, and careful attention to such language is important to minimize the impact.

Private equity firms will see increased focus on the financial health of each portfolio company during GPL underwriting, in addition to the increased scrutiny each portfolio company faces during its own D&O renewal. This will require more time and effort from companies already stretched thin by other business issues.

Bankruptcy and insolvency exposure for portfolio companies will be reviewed, and companies should review related D&O policy provisions. Predetermined run-off terms can be critical, but financial distress concerns may cause insurers to pause. Side A limits should also be reviewed and increased where possible.

Finally, if onerous terms are a reality at renewal, consider a notice of circumstances in the event an insurer is materially restricting coverage. That can be a complex process and you should seek advice from your broker and coverage counsel should you pursue this path. But if you are aware of facts that could reasonably be expected to give rise to a claim, submitting a notice of circumstances should be considered.



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