



COVID-19 and executive risk: how can D&O coverage help in this pandemic?

Organizations around the world have been dealing with a myriad of COVID-19-related issues and resulting financial and operational hardships. Risks associated with directors and officers (D&O) liability are among the many risks that are top of mind. In the context of this pandemic, the risks may include:

- The adequacy and accuracy of disclosures in a financial/business environment with so much in flux, including many businesses trying to cope with shutdowns and other unprecedented pressures.
- Fiduciary and other duties owed. Changes are occurring quickly and there is no real precedent for many of today's tough decisions.
- Complications and challenges in balancing the needs and priorities of today's diverse and complex interests among key stakeholders.
- Regulatory and compliance uncertainty in facing unparalleled events and responses by authorities.
- Workforce and operational adjustments bring new, potentially unanticipated risks.
- Legal, financial and other external advisors may be overtaxed or unavailable as many others are wrestling with COVID-19 related issues.
- Reputation risk arising from perceptions, well-founded or not, of how management has responded to the pandemic.

Below, we address D&O insurance coverage issues and questions, including how we would anticipate a foreseeable D&O claim to be addressed, coverage and policy language considerations, and emerging changes in D&O underwriting behavior.

Do COVID-19 D&O claims fall within policy insuring agreements?

Insuring clauses in both public company and private company D&O policies typically have broad triggers. The coverages are segregated into three distinct insuring grants: coverage for non-indemnified D&O loss (Side A), indemnified D&O loss (Side B), and organizational loss, or "entity coverage" (Side C). All three grants customarily cover "loss" resulting from "claims" against an "insured" "for a wrongful act."

Applying the traditional definitions of these terms, the foreseeable COVID-19 D&O claim would fall within the insuring agreements, thus being potentially covered and subject to the policy's remaining terms and limitations. Importantly, entity coverage would not be available to a public company for negligence-based claims that are unrelated to the purchase or sale of company securities, as public company entity coverage is almost always exclusive to "securities claims." As an example, a COVID-19-related securities claim may involve

a shareholder class action alleging violations of securities laws relating to the adequacy of COVID-19 risk disclosures. As of this writing, two such actions have been filed.

The policy may also extend to cover costs associated with certain government investigations and inquiries. Wording varies from company to company and product to product.

To be clear, D&O wording is not likely to speak to specific risks associated with COVID-19. Nevertheless, most policies will respond well to traditional D&O perils, even those triggered by COVID-19 events. This “silent COVID-19” coverage is “silent” because it does not expressly address pandemic perils, but it may nevertheless respond to them.

Beware of coverage limitations potentially being applied in unexpected ways

- **Bodily injury exclusion:** Generally, there are two types of bodily injury exclusions. The first excludes losses “for” bodily injury, sickness, disease, etc. – i.e., direct losses, such as medical expenses. To the extent a COVID-19 claim seeks damages for indirect financial losses, we do not anticipate the exclusion to be a coverage impediment. A second, broader variation of the exclusion, often found in the policies of healthcare and life sciences companies, and companies engaged in more hazardous operations, precludes coverage for claims “based upon, arising out of” a bodily injury. Exceptions to the exclusion for Side A losses and securities claims may be available.
- **Pollution exclusion:** Pollution exclusions preclude coverage for claims “for” or, alternatively, “based upon, arising out of,” the release or dispersal of pollutants, including specified contaminants, some of which may have a bearing on COVID-19 claims. Examples may include “germs,” “viruses,” and “biological irritants.” Exceptions to the exclusion may be available for Side A losses and securities claims.
- **Conduct exclusion:** The exclusion for intentional/deliberate acts may trigger upon a final, non-appealable adjudication of such conduct. In light of the high hurdles of intentionality and adjudication, we would not envision the exclusion to apply in most COVID-19 cases.
- **Professional services (E&O) exclusion:** Similar to a bodily injury exclusion, should an E&O exclusion appear in a policy, it is likely to exclude loss “for” or “based upon, arising out of” acts or omissions in the rendering or failure to render professional services. The “based upon” wording may have more impact in COVID-19 cases for companies in affected industries, such as healthcare and life sciences. Exceptions for Side A losses and securities claims may be available.
- **Other insurance:** Should claims trigger coverage under the D&O policy, they may also implicate additional coverage lines, such as general liability or environmental. How each policy responds, whether as primary, excess, or via a shared arrangement, will depend on the specifics of the claim and the additional policies’ respective other insurance wordings.



Coverage considerations for private companies

Although public and private companies policies have similar structures and share common terms, there are differences that may be material in a COVID-19 claim. For example, private company policies afford broader entity coverage. Thus, negligence-based claims against a private company relating to COVID-19 risk mitigation, preparedness, response measures, among others, may be covered. In contrast, the public company's entity coverage is implicated only in securities claims.

Private company policies may also provide insureds with more options in how claims are defended. Where public company policies almost always afford the insured with coverage for indemnification of approved costs incurred through counsel selected and managed by the insureds, private company policies may impose upon the insurer a duty to defend claims or, in other cases, may give the insured the option of defending itself or transferring that obligation to the insurer. Policies with an optional duty to defend feature generally provide a limited period in which insureds may tender that defense to the insurer before the option is lost. Choosing whether to keep control of the defense of a claim or to tender it to an insurer can involve a complex balance of advantages and disadvantages. Your broker and legal advisor should be consulted as early as possible to help with that assessment.

In addition, with broader entity protection, private company policies will customarily have more exclusions unique to the company's Side C coverage. Examples include: contractual liability exclusions, which in the context of COVID-19, may be relevant to alleged failures to fulfill contractual obligations due to disruptions in travel, product or services sourcing, and logistics; and employment practices exclusions, which may apply to claims relating to layoffs or other corporate actions impacting employees.

Bankruptcy considerations and D&O coverage

With a potential global recession on the horizon, cascading bankruptcies could well disrupt whole industries or economies. Previously well-performing businesses may find themselves confronted with mandated closures, seemingly insurmountable workforce challenges, and cash management concerns. Meanwhile, the advancement and indemnification protections executives typically rely on to protect themselves may not be available when they need them most. D&O coverage may be the only protection they can count on. As expense pressures grow, D&O coverage is not a place to look to cut costs. It has never been more important.

With this in mind, companies should turn their attention to policy provisions that have the potential to come into play in these situations.

- **Side A:** Coverage for non-indemnifiable D&O losses could be impacted to the extent bankruptcy law restrictions may curtail the company's ability to advance or indemnify losses. Side A is a critical, last-line-of-defense coverage that should be a part of every enterprise's D&O risk management plan. It should be considered a D&O coverage tool that can yield dramatically different results depending on strategic choices relative to breadth and levels of coverage, form choices, coverage enhancements, and program structure.
- **Bankruptcy waiver:** A bankruptcy clause may comfort directors and officers by specifying that (1) a bankruptcy filing will not relieve the insurer of its coverage obligations, (2) the policy is intended to benefit individual insureds as a matter of priority, and (3) the parties will not to oppose or object to efforts by the insurer or insureds to obtain relief from the automatic stay to pay claims.
- **Order of payments:** An order of payments provision provides that the insurer will prioritize claim payments under Side A before paying losses under Side B or C. In some cases, the clause may authorize the organization to advise the insurer to delay payments under Sides B and C in favor of future Side A payments.
- **Entity v. Insured/Insured vs. Insured exclusion:** In the context of bankruptcy, claims may be asserted against directors and officers by trustees, receivers, and other bankruptcy constituencies. To mitigate against application of the exclusion, companies should seek to exempt such claims from the exclusion.

Potential opportunities from often overlooked first-party coverages

- **Crisis management:** First party coverage may be available in some instances for crisis management expenses to the extent a company has experienced a “crisis” due to COVID-19 factors. Events that may trigger coverage include negative earnings announcements, key executive resignations, employee layoffs, product recalls, elimination or suspension of dividends, among others. The coverage is customarily subject to a sublimit of liability.
- **Reputational risk:** Similar to crisis management coverage, some policies may include first party coverage for a director’s or officer’s “reputation crisis.” Also traditionally sublimited, the coverage may be applicable to individuals to the extent their reputations are adversely impacted by certain developments arising from a COVID-19 crisis. The triggers may be narrow and could require the act of an enforcement authority.
- **Business interruption:** D&O policies do not cover first party business interruption exposures. Should a company experience losses due to a permanent or temporary shutdown of operations, neither public nor private company D&O policies would afford coverage; however, third party liability claims, such as lawsuits arising out of a business shutdown or other interruption, may be covered.



Get ready early for a challenging renewal

As of this writing, we are beginning to experience changes in the underwriting of D&O risks. These changes are happening on the heels of an already firming, and in some segments, hard market. Adding to the mix of firming conditions, COVID-19 is likely to present new dimensions to renewal challenges. For starters, in advance of renewal, especially those in the nearer term, insureds should expect heightened underwriter focus on COVID-19 impact, plans and disclosures.

So far, top D&O underwriting areas of focus are liquidity and industry. Inquiries may be tailored to company-specific concerns or they be limited to a consistent COVID-19 questionnaire that asks the same questions of all insureds. Inquiries may also drill down on COVID-19-related risk disclosures, the impact on financial results, operations, product/services shortages, industry-wide concerns, liquidity/solvency, and cyber security. For some companies, insurers may attempt to modify terms that were, several weeks back, formally or informally quoted or conveyed.

Conclusion

We are in fluid and changing times. Companies should engage their brokers on COVID-19 D&O risk more deeply and scrutinize coverage terms going forward. We encourage companies to begin renewal protocols early, and to advise their brokers of anticipated changes in exposures, such as M&A transactions and bankruptcy filings. Previously challenging market conditions are likely to become more challenging very quickly. Although coverage may also be more expensive, with the heightened risk this environment presents, it may be far more valuable today than it ever was.

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Each applicable policy of insurance must be reviewed to determine the extent, if any, of coverage for COVID-19. Coverage may vary depending on the jurisdiction and circumstances. For global client programs it is critical to consider all local operations and how policies may or may not include COVID-19 coverage.

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