Marsh

D&O coverage considerations before, during, and after an IPO

An initial public offering (IPO) presents many financial benefits, but also materially changes a company’s risk profile.

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The IPO process adds significant exposure to the personal assets of a company's directors and officers and draws increased scrutiny from regulators, plaintiffs' attorneys, and the public. A comprehensive directors and officers liability (D&O) insurance policy is a critical step to effectively managing this risk before and after the offering.

Roadshow risks

The journey from private to public company is fraught with new risks and exposures. Exposure to securities liability typically begins with the company's IPO roadshow, or even as a business makes legal, tax, and operational decisions leading up to it. Investors rely heavily on statements made during roadshow presentations, including information provided within a company's prospectus. Allegedly misleading statements made during this time, or failure to execute the IPO, can lead to claims.

If D&O insurance is in place prior to an offering, this is typically on a "private" policy form and coverage is often tailored to the needs and risks of a private company. Some D&O policies allow for roadshow coverage as part of the base "private company" policy wording. Other insurers, however, specifically exclude this coverage — meaning that the policy form would need to be endorsed. "Failed IPO" coverage is also important should the company be unable to execute the offering. While some insurers may exclude this coverage, others might be willing to add it by endorsement onto a private company D&O policy.

If a company does not have any D&O coverage in place, it should consider partnering with an insurer with appetite for public company exposure to purchase coverage prior to its roadshow and preliminary prospectus filing. It is important for the company and its directors and officers to seek proper advice early on in the process to ensure that their nuanced coverage needs are adequately addressed. This is also the case for companies able to take advantage of the JOBS Act's easing of IPO filing requirements, those considering a direct listing, or foreign filers.

DIRECT LISTINGS AND SECTION 11 LIABILITY NUANCES

In a direct listing, a company's existing, outstanding shares are listed without the assistance of underwriters or a primary or secondary offering. Since a company typically registers some — but not all — outstanding shares, a mixed market of registered and unregistered shares is created, making tracing difficult once trading commences. Section 11 liability remains even though the shares cannot be traced. D&O implications for direct listings include:

- **Stock volatility.** Underwriters do not control the listing price and insiders can immediately sell shares, creating an elevated risk of post-listing price volatility.
- **Errors and omissions.** Underwriters provide less counsel and fewer safeguards in a direct listing than an IPO, which could lead to an omission and/or misrepresentation.
- **No lock-up period.** There is potential for selling shareholders to make misstatements as they can sell shares immediately upon listing.
- **No capital raise.** The company does not directly benefit from raising capital, so plaintiffs can argue it is not in the best interest to undertake a direct listing.
- **Class.** A direct listing could restrict the class of persons who have standing to sue under Section 11.
- **Damages.** As there is no offering price to calculate damages, a direct listing potentially limits plaintiff damages under a Section 11 claim.
- **Defense costs.** A discovery stay under the Private Securities Litigation Reform Act is not a bar to jurisdictional discovery, so defense costs may increase early in litigation to determine tracing.

Post-IPO exposures

Public companies are subject to greater regulatory scrutiny than private companies and must comply with extensive securities laws designed to enhance public trust and corporate governance. Disclosure requirements for public companies can create significant liability. All statements made during a roadshow or contained within the prospectus and any subsequent public disclosures of material information should be carefully considered and reviewed by outside counsel.

One of the biggest IPO risks is stock underperformance after listing, which can lead to lawsuits against the company and its directors and officers alleging mismanagement and misrepresentation in the prospectus, among other claims. Such lawsuits are almost always based on the strict liability provisions of Section 11 of the Securities Act of 1933. Under this law, any material misrepresentation — even if negligently made — could form the basis of liability against a corporate director and officer.

While the vast majority of securities class-action complaints are filed in federal court, in recent years Section 11 claims have also been filed in state courts, where there are more lenient pleading standards, more permissive procedures, and lower dismissal rates than in federal courts. Section 11 claims have become known as "concurrent jurisdiction" claims, because they can be filed in state, federal, or both courts at the same time.

Depending upon the severity of the problem and the drop in stock price, an IPO could also draw the attention of state and federal securities regulators and other enforcement agencies, potentially resulting in concurrent regulatory investigations, further increasing the overall costs. However, following the *Blue Apron* and *Restoration Robotics* decisions (see sidebar), Delaware corporations can now file registration statements to include provisions in their charters requiring that Section 11 actions be filed in federal court. While these recent decisions are considered wins for companies thinking about going public, their potential effect on D&O premium pricing still needs to be seen.

Common post-IPO trigger events leading to securities claims include:

- Accounting restatements.
- Earnings failing to meet projections.
- Announcement of products or services failing to perform as expected or being delayed.
- Investigations by the Securities and Exchange Commission, Department of Justice, or other regulators into corporate conduct or that of individual directors and officers.
- Internal investigations based on whistleblower complaints.
- Inadequate disclosure regarding mergers, acquisitions, and divestitures.

RELEVANT IPO LITIGATION

Cyan, Inc., et al. v. Beaver County Employees Retirement Fund, et al (March 2018)
The US Supreme Court ruling that the Securities Litigation Uniform Standards Act of 1998 does not eliminate state courts' jurisdiction over Section 11 cases means that state courts have concurrent subject matter jurisdiction over class actions alleging violations of Section 11. As a result, directors and officers who sign registration statements related to IPOs may now be targeted in Section 11 litigation brought by shareholders in both federal and state courts, resulting in parallel, duplicative litigation in state and federal courts.

Matthew B. Salzburg et al. v. Matthew Sciabacucchi
(March 2000)
The Delaware Supreme Court reversed a lower court's decision about the validity of federal-forum selection provisions (FFPs) in a "win" for Delaware incorporated companies contemplating some type of offering. Following the *Blue Apron* decision, Delaware corporations can now file registration statements to include provisions in their charters requiring that actions arising under the Securities Act of 1933 be filed in federal court.

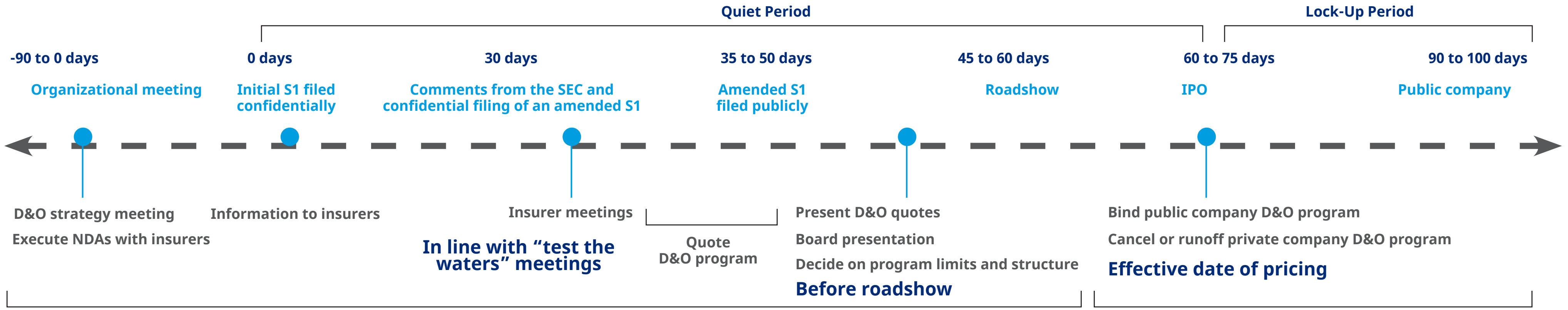
Wong v. Restoration Robotics, et al (September 2020)
In a significant opinion, the Superior Court in California's San Mateo County dismissed this Section 11 case for lack of jurisdiction due to federal forum provisions in the company's certificate of incorporation. This first dismissal was issued by Judge Weiner in San Mateo County, whose court is regarded as the beginning of the Section 11 State Court phenomenon.

Building an effective D&O program

Before launching an IPO, businesses should work with their insurance advisors to build a D&O insurance program that addresses their critical risks before, during, and after an offering. Businesses can follow a simple process (see Figure 1) that can minimize time and effort while better ensuring robust coverage is in place. In building D&O programs ahead of IPOs, risk professionals should work with their insurance advisors to:

- Assess limits needed and optimal program design based upon tailored benchmarking and securities class-action claim modeling.
- Differentiate the company's risk profile, highlighting positive underwriting characteristics to help set it apart from competitors.
- Prepare for meetings with potential insurers (including global markets) using the draft prospectus and latest financial statements.
- Negotiate, evaluate, and select D&O program structure, including consideration for international exposures.
- Prepare and present the D&O program to the company's board/audit committee.
- Ensure proper placement of coverages for ancillary lines, such as cyber, employment practices liability, fiduciary liability, and crime.
- Conduct a midterm stewardship meeting with both the underwriting and claims teams from the primary insurer.

01| D&O coverage timeline during an IPO



Private company D&O considerations:

- Roadshow coverage.
- Failed IPO coverage.
- Partner with carrier with appetite for IPOs.
- Discuss runoff or policy cancellation and unearned premium treatment.

Public company D&O considerations:

- Increase limits.
- Expect higher retentions and premium.
- Purchase dedicated Side A coverage.
- Maintain continuity date of private company limit.
- Purchase standalone EPL, fiduciary, and crime.
- Review international exposure (locally admitted D&O policies).

Although warranties are currently waived, this may change.

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