MARSH

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Heighted Risks for Energy Directors and Officers

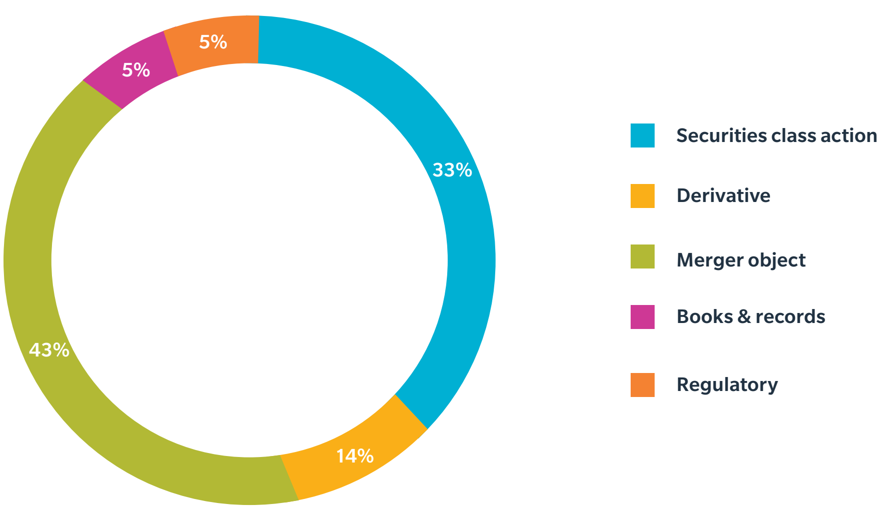
The energy and power sector is under immense pressure as widespread measures to stem the spread of the COVID-19 pandemic led to an unprecedented collapse in oil demand at the same time the price of oil tumbled. As a result, some energy businesses could face bankruptcy or require restructuring.

As the risk landscape continues to evolve, the directors and officers of distressed energy companies will be tasked with making difficult decisions to protect their organization. This puts them at heightened exposure of litigation and financial loss.

There were 21 directors and officers (D&O) liability claims in the energy sector in the first half of 2020 (see Figure 1), which is in line with the historical average of 10 per quarter.

FIGURE 1 Energy D&O Claims — January to June 2020

SOURCE: ADVISEN



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*Companies in **corporate distress** are under a form of financial or organizational stress to the extent that management is seeking a strategic alternative to the historical business model.*

ENERGY D&O CLAIMS HISTORY: EFFECTS ON PREMIUMS IN THE US AND CANADA

An average of 40 energy sector D&O claims are made in the US every year. These include derivative actions, regulatory actions, single plaintiff shareholder claims, creditor claims, and securities class actions. The latter account for between 1% and 8% of all US federal security class action filings each year.

D&O premiums in the US were generally decreasing up to 2018 when rates started to climb. Energy sector D&O premiums performed generally better than the overall market until the fourth quarter of 2019, when we started to see higher increases.

In Canada, the energy sector has accounted for 10 out of the 100 secondary market liability claims filed since 2006. The largest settlement to date was $53 million, with a median of $22.8 million. The majority of the claims pertained to corporate governance matters such as accounting irregularities and guidance projections.

Times of corporate distress are likely to heighten the risk of claims for the energy sector; up to 10% of energy sector bankruptcies over the past five years also experienced D&O claims, leading to increased concern for the personal exposure of directors and officers of companies in **corporate distress**.

Energy companies can take steps to protect their directors and officers during times of distress, primarily through the purchase of a robust D&O liability insurance program that specifically addresses bankruptcy liability. And directors and officers themselves should pay close attention to their fiduciary duties during times of distress, including by thoroughly evaluating organizational documents, focusing on fairness, solvency, and/or reasonably equivalent value opinions, understanding the need for special committees, and ensuring adequate investor disclosures.

D&O Renewals in Challenging Circumstances

The current challenging landscape shines a spotlight on the need for energy sector companies to follow a carefully outlined action plan, starting at least four to six months before their D&O insurance renewals and focusing on enhancing their relationship with their insurer and improving their renewal outcome. Even companies that are not in distress can use this time to adequately prepare information for underwriters about company performance. Underwriters are likely to inquire about the company's performance in relation to COVID-19 issues and its ability to endure current industry challenges.

From a policy structure standpoint, some energy companies facing unmanageable D&O insurance costs are also looking at higher retentions (up to $50 million for very large companies), reducing Side BC coverage and replacing it with Side A coverage, or using a captive for Side BC coverage. Although not common, some are considering a trust for Side A coverage.

Corporate insolvency is a key concern for D&O underwriters as management takes on complex issues to prepare for a bankruptcy filing. As a result of this heightened insolvency risk, D&O underwriters are expected to pay close attention to the financial strength and liquidity of energy companies.

In addition, overall concerns about this sector mean that many underwriters are also assessing higher premiums even against companies that are doing well. Buyers of such companies need to be prepared to make numerous counterarguments and reinforce the health and resilience of their company's risk profile.

What to Share During Underwriting Presentations

Although each company's situation is different during these challenging times, energy organizations should communicate key takeaways and the company's risk management story in a transparent manner while highlighting favorable risk characteristics to help underwriters appreciate the merits of the risk.

Underline any actions that your company is taking during the current difficult period, including liquidity and hedging strategies. You should also discuss your company's accident prevention and safety record and corporate culture. These are of particular importance as event-driven litigation, resulting from the inherent hazardous nature of the business, remains a key contributor of D&O claims.

The current challenging business environment comes at a time when pricing for D&O liability insurance is on the increase. This upward swing predates the COVID-19 pandemic, but is now accelerating given new risks now facing companies. Thus, it is essential for energy organizations to be well prepared for their underwriting meetings and secure optimal coverage for their directors and officers.

D&O COVERAGE FOCUS AREAS FOR DISTRESSED ORGANIZATIONS

During renewal negotiations, distressed energy companies should, to the extent possible:

- Negotiate the removal of full bankruptcy exclusions, either as an endorsement or as an embedded policy exclusion.
- Closely review the policy's "change of control" wording. In almost all cases, the policy run-off trigger should be set when the company's ownership and board changes, which typically happens at emergence in a Chapter 11 case.
- Remove exclusions for suits brought by a trustee, creditor committee, or debtor in possession. Such wording is typically embedded within the "insured versus insured" exclusion and can be removed through negotiation.
- Avoid provisions that permit insurer cancelation or otherwise reduce coverage in the event of policyholder credit downgrades.
- Request the removal of pollution exclusions: While once a standard exclusion, many D&O insurers will agree either to fully remove this exclusion or, at a minimum, amend it so as not to apply to securities claims.

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