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D&O Claim Scenarios: Privately Held Companies

Privately held companies face a broad range of D&O exposures driven by **ownership disputes, creditor actions, regulatory scrutiny, and operational decisions.** Unlike public companies, claims frequently stem from **shareholders, lenders, competitors, and employees (non-EPLI capacity).**

The following scenarios are mapped to:

- Claim type
- Typical trigger
- Insuring Agreement response
- Coverage considerations

1. Minority Shareholder Oppression/ Breach of Fiduciary Duty

Scenario

A minority shareholder alleges that the CEO and majority owners:

- Paid themselves excessive compensation
- Withheld dividends
- Diluted minority ownership through a restructuring

Claim Allegations

- Breach of fiduciary duty
- Self-dealing
- Oppression of minority shareholders

Coverage Response

- **Side A:** Covers individual directors/officers if indemnification is not provided
- **Side B:** Reimburses company if it indemnifies management
- **Entity Coverage:** Typically limited; may not apply depending on policy (private forms sometimes include coverage)

Key Considerations

- One of the **most common claims in private D&O**
- Often tied to **closely held ownership structures and exit disputes**
- Defense costs alone can be significant even without settlement

2. M&A Transaction Dispute

Scenario

After acquiring a smaller competitor, the buyer alleges:

- Misrepresentation of financials
- Failure to disclose key liabilities
- Inflated revenue projections

Claim Allegations

- Misrepresentation
- Breach of fiduciary duty
- Fraud (often alleged, not proven)

Coverage Response

- **Side B** typically primary (company indemnifies management)
- **Side A** if indemnification is denied or individuals are named separately

Key Considerations

- Policies may include **transaction-related exclusions** depending on structure
- Representations & warranties insurance may overlap but does not replace D&O

3. Creditor/Lender Claims (Insolvency-Related)

Scenario

Following financial distress or bankruptcy, creditors sue directors alleging:

- Mismanagement leading to insolvency
- Preferential payments to insiders
- Failure to pursue viable strategic alternatives

Claim Allegations

- Breach of fiduciary duty to creditors
- Deepening insolvency
- Negligent misrepresentation

Coverage Response

- **Side A critical** (company often unable to indemnify in insolvency)
- Side A DIC policies become particularly valuable

Key Considerations

- High-severity exposure
- Bankruptcy trustees frequently bring derivative claims
- Retentions may not apply to Side A coverage

4. Regulatory Investigation (Non-Securities)

Scenario

A healthcare or fintech company is investigated by regulators for:

- Improper billing practices
- Compliance failures
- Data handling violations

Claim Allegations

- Mismanagement and governance failures
- Failure of oversight

Coverage Response

- Policies may cover **formal investigations of insured persons**
- **Side A / Side B** depending on indemnification
- Entity coverage may be limited to certain regulatory proceedings

Key Considerations

- Coverage depends heavily on **definition of "Claim" and "Investigation"**
- Informal inquiries are often not covered

5. Customer/Competitor Misrepresentation Claim

Scenario

A competitor sues alleging the company's CEO made false claims about product capabilities that caused:

- Lost business
- Market confusion

Claim Allegations

- Misrepresentation
- Unfair competition
- Trade libel

Coverage Response

- May trigger **Entity coverage** under private company forms
- **Side B** for individuals if indemnified

Key Considerations

- Potential overlap with **professional liability or E&O coverage**
- Conduct exclusions (fraud) apply only if adjudicated

6. Employee Claim in a Non-EPLI Capacity

Scenario

A senior executive alleges:

- The board mismanaged a sale process
- Resulted in loss of equity value tied to compensation (Note: Not a classic wrongful termination claim)

Claim Allegations

- Breach of fiduciary duty
- Misrepresentation regarding company valuation

Coverage Response

- Covered under **D&O (not EPLI)**
- Side B or Side A depending on indemnification

Key Considerations

- Important distinction: capacity of **claimant vs nature of claim**
- Executive equity holders drive frequent exposure

7. Failure to Maintain Adequate Insurance

Scenario

Following a major uninsured loss, investors sue the board alleging:

- Failure to procure appropriate insurance coverage
- Poor risk management decisions

Claim Allegations

- Breach of fiduciary duty
- Negligence in oversight

Coverage Response

- **Side B / Side A** depending on indemnification

Key Considerations

- Common after cyber events, property losses, or large liability events
- Often framed as governance failures rather than operational issues

8. Misstatements to Investors (Private Placement)

Scenario

Investors in a private capital raise allege:

- Financial projections were misleading
- Key risks were not disclosed during fundraising

Claim Allegations

- Misrepresentation
- Breach of fiduciary duty
- Securities law violations (private offerings)

Coverage Response

- **Entity coverage typically applies** under private company D&O
- Side B for indemnified individuals

Key Considerations

- Private company D&O forms often include **broader entity coverage vs public company forms**
- High severity, particularly with institutional investors

9. Board-Level Governance Failure/ Oversight Claim

Scenario

A significant operational failure (e.g., cybersecurity breach, safety incident) leads to claims that:

- Board failed to implement adequate controls
- Ignored red flags

Claim Allegations

- Breach of duty of care
- Failure of oversight (Caremark-type claims)

Coverage Response

- **Side B / Side A**
- Potential Side A DIC involvement if indemnification blocked

Key Considerations

- Increasing frequency across industries
- Often follows major adverse corporate events

10. Derivative Action Brought by Investors

Scenario

Investors bring a derivative lawsuit on behalf of the company against directors for:

- Mismanagement
- Improper strategic decisions

Claim Allegations

- Breach of fiduciary duty
- Waste of corporate assets

Coverage Response

- **Side B** (company indemnifies directors)
- Entity not covered for derivative damages (but defense may be)

Key Considerations

- Settlements often structured as **corporate governance reforms** plus legal fees
- Defense costs are primary driver of loss

Key Takeaways for Clients

Most Common Drivers of Loss

- Ownership disputes (minority vs majority)
- Financial distress / insolvency
- M&A activity
- Capital raises and investor communications

Coverage Observations

- Side A protection is critical, especially in bankruptcy or derivative contexts
- Private company policies often provide **broader entity coverage** than public D&O
- Definitions (e.g., "Claim," "Loss," "Insured Person") materially impact outcomes

Risk Management Considerations

- Maintain **formal governance processes and documentation**
- Carefully manage **investor communications and financial disclosures**
- Conduct **pre-transaction diligence** and document decision-making
- Evaluate **Side A DIC towers** for added protection