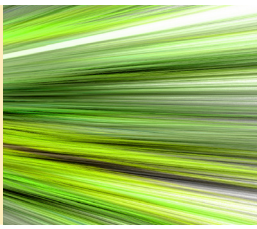

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D&O IPO - Does Your Exit Have a Roadblock Around the Corner

By Brendan Williams.[1], Senior Vice President & Partner

AS A PRE-IPO COMPANY, WHAT ARE THE MAIN REASONS TO PURCHASE D&O COVERAGE SOONER RATHER THAN LATER?

Directors and officers are subject to personal unlimited liability so it is critical to ensure proper D&O coverage is in place well in advance of a liquidity event. In addition, a well structured D&O insurance policy will serve to protect the corporation's balance sheet from unforeseen circumstances or events that might otherwise derail the initial public offering ("IPO"). Finally, pre-IPO companies are often looking to attract and retain key outside board members and executive positions prior to the IPO and the most qualified individuals will often want to review the limits, terms and conditions.

WHAT IS THE EXPOSURE A NEWLY PUBLIC COMPANY FACES FROM A D&O LIABILITY STANDPOINT?

From a dollars perspective, the largest threat that public company directors and officers face is the threat of a federal securities class action suit that alleges violations of the federal securities laws. The exposure is significant and the trend in average cash settlements has increased substantially in the past 10 years. The average cash settlement in 2012 was $39.1 million, compared to $18.5 million in 2003[2]. And that does not include defense costs which have increased significantly in the past 3-5 years.

Furthermore, nearly 50% of the roughly 4,900 securities class action lawsuits that have been filed since 1990 have targeted companies in the first three years post-IPO[3]. One of the primary reasons for this high percentage is that in its early public years, a company's corporate governance often is lacking from a D&O liability perspective. There is also oftentimes a lack of awareness at the executive and board level of the red flags that the plaintiffs' bar looks for when determining whether they will file a securities suit. Finally, the pleading standard relative to '33 Act (or prospectus liability) exposures is much lower which leads to plaintiffs often targeting newly minted public companies. This underscores why it is so critical to have a solid foundation of corporate governance in place prior to becoming a public company. Doing so significantly minimizes your D&O liability risk which results in lower D&O premiums and better overall protection.

WHEN SHOULD A PRE-IPO COMPANY START PREPARING THEIR D&O INSURANCE FOR THE LIQUIDITY EVENT?

A company should start preparing their D&O insurance for the liquidity event at least 12-18 months prior to the targeted IPO date. There are several critical terms and conditions within a pre-IPO D&O policy that need to be amended to respond to exposures that a company will face in the months leading up to the IPO.

ARE THERE ANY CRITICAL D&O ITEMS THAT ARE OFTEN OVERLOOKED ON THE WAY TO BECOMING A PUBLIC COMPANY?

Aside from amending the D&O policy to reflect pre-IPO exposures, one of the most critical and often overlooked items is to ensure that the company has purchased D&O insurance with insurance carriers that can be depended upon when the company goes public. There are approximately 30 D&O insurance carriers in the marketplace but only a very small handful that will quote a competitive primary option on an IPO company. The last thing you want is for your D&O carrier to leave you at the altar when you need them the most—at your IPO. A strong relationship with your D&O carrier and the few thou-

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[2] D&O Databox, excludes case settlements over $1B.

[3] D&O Databox (Woodruff-Sawyer & Co. Proprietary D&O Litigation Database) 2009.

sand dollars in premiums spent on a private D&O policy could prove very beneficial should the D&O marketplace turn and the capacity diminish in the future.

FROM A D&O PERSPECTIVE, WHAT ARE SOME OF THE COMMON MISCONCEPTIONS THAT CONTINUE TO EXIST RELATIVE TO COMPANIES GOING THROUGH THE IPO PROCESS?

One of the biggest misconceptions in the D&O insurance marketplace is that a precipitous stock drop will result in a securities suit. While a precipitous stock drop will attract the attention of the plaintiffs' bar, the stock drop is often only one of many reasons why companies are ultimately sued. The more important issue is whether senior management has developed a risk profile that includes appropriate policies and procedures that would discourage the plaintiffs' bar from bringing an action. As such, effective D&O "loss control" is oftentimes overlooked in the insurance process.

Another common misconception involves the fact that the D&O policy a company purchases here in the United States will respond seamlessly to suits brought in foreign jurisdictions. Outside the United States, directors' and officers' litigation risk changes dramatically. The concern with shareholder class action litigation is replaced by attention to a variety of country-specific regulations regarding the duties, responsibilities and obligations of board members and company managers. If your company has a global footprint, it is critical that an international analysis is done and the D&O insurance program is carefully drafted to respond to overseas liabilities.

WHAT ARE SOME OF THE STRATEGIES THAT A COMPANY CAN USE TO OBTAIN THE BEST POSSIBLE D&O COVERAGE FOR THEIR IPO FROM THE INSURANCE CARRIERS?

Generally speaking, D&O insurance underwriters will review the registration statement and some will even look at the amended filings and attachments. However, it is important that the pre-IPO company tell their story personally via D&O insurer meetings that take place well in advance of the ultimate pricing date. In addition, the ability to proactively articulate and highlight the company's governance infrastructure and proactively differentiate its loss control strategies to the D&O insurers will result in better terms, conditions and pricing.

DOES A PRIVATE AND PUBLIC COMPANY D&O POLICY PROTECT MY COMPANY FROM EVERYTHING OR ARE THERE OTHER THINGS WE SHOULD BE DOING TO PROTECT OURSELVES?

It is our firm belief that true corporate and executive protection begins well before the D&O insurance policy is placed. There are several ways that corporations and its directors and officers can protect themselves from litigation and a potential unindemnifiable loss. Some of these risk management techniques include:

- Strengthening indemnification agreements
- Insider Trading policy review and education
- Disclosure counseling
- Corporate Governance review
- Foreign Corrupt Practices Act ("FCPA") training

HOW CAN WOODRUFF-SAWYER HELP A COMPANY WITH ITS D&O NEEDS?

The reason we've served as the exclusive D&O insurance broker on nearly half of the California IPOs that have priced since 2010 and are the leading nationwide D&O IPO broker is due to the fact that our holistic approach is unique from every other insurance broker. We put much more emphasis on corporate governance on the front end and assist our clients in developing a D&O Governance Risk Profile which we incorporate into our negotiations with the D&O markets to maximize terms and conditions at the most competitive premiums. We are also the only broker that will proactively review the personal indemnity agreements on behalf of our directors and officers.

We combine the aforementioned governance profile with a proprietary database that includes every shareholder class action filed since March 1988. This database forms the backbone of the decision making approach regarding D&O limits. It is a very realistic and data-driven guide to D&O limits adequacy and it ultimately ensures a more defensible and knowledgeable D&O client and Board.

Woodruff-Sawyer is one of the largest independent insurance brokerage firms in the nation. Due to its unique and holistic approach to the D&O insurance process, Woodruff-Sawyer has served as the exclusive D&O insurance broker on 44% of all IPOs that have priced in California in 2013 and is the leading D&O insurance broker nationwide for IPOs. For more information on D&O IPO insurance or to discuss your IPO insurance needs, please contact Brendan Williams at 949.435.7342 or bwilliams@wsandco.com.