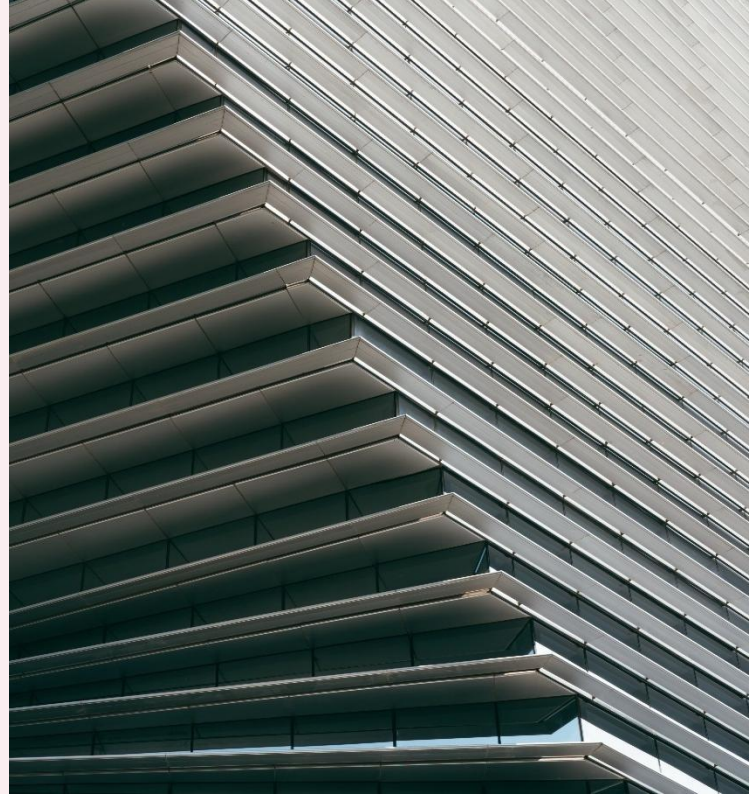


Side C cover in D&O Insurance: what it is, how it works, and why it matters for "stock drop" claims

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As shareholder claims become increasingly common, listed companies should review their directors' and officers' ("**D&O**") insurance arrangements to assess whether they hold "Side C" cover that may respond to such claims, and if that cover is adequate.

Key issues

- 1 Side C cover in D&O insurance policies provides cover to companies defending securities litigation.
- 2 Listed companies should review their Side C cover in view of the increase in securities litigation.
- 3 Companies should consider whether the policy terms and limits are appropriate and understand how those limits are shared with the directors and officers of the company.
- 4 Companies should also understand the notification requirements in their D&O insurance and confirm that any exclusions related to dishonesty/fraud will only apply after a final adjudication.

D&O insurance is generally divided into three components:

- **Side A** covers the liability of directors and officers, where the company cannot and/or does not indemnify them;
- **Side B** reimburses the company where it has indemnified a director or officer; and
- **Side C** responds to claims brought against the company itself, generally for securities related actions. Side C is usually an optional add-on to D&O policies.

The growing focus on Side C coverage reflects the rise of securities litigation in the UK, with claims under sections 90/90A of the *Financial Services and Markets Act 2000* (colloquially known as "stock drop" claims), once relatively rare, now being pursued more frequently by institutional and retail investors, often with the backing of litigation funders and after the event insurance.

Side C cover

- Provides cover to a listed company in respect of third-party claims related to the company's securities (e.g. shareholder actions).
- May provide cover for the company's defence costs as well as any judgment or settlement entered into with the insurer's consent.
- Policy limits are often shared with the Side A and B covers used by directors and officers.
- Will generally contain an exclusion for fraudulent/dishonest conduct.

In these types of claims, the company is typically alleged to have made a misleading statement to the market, which is subsequently uncovered and causes a fall in the share price. Investors who bought, held or sold shares during the relevant period may bring claims, often on a group basis, against the company for the resulting loss of share value. Side C will generally provide cover to the company for its defence costs in responding to such claims, as well as for any adverse judgment against the company or a settlement entered into with the insurer's consent.

However, there are a number of important issues that companies should consider when purchasing or reviewing Side C cover:

1. **Side C is not automatically included in D&O programmes:** Some D&O insurance programmes only include Sides A and B by default. Listed companies should ensure that they also purchase Side C cover if they are at risk of facing claims related to their securities, such as "stock drop" claims.
2. **Check how the policy limit applies amongst Sides A, B and C:** D&O programmes often operate on the basis that the limit is shared by all insureds and will be eroded by all claims across the Side A, B, or C covers.

In complex, high-value claims such as "stock drop" litigation, policy limits can be eroded quickly, particularly where directors and officers are named as defendants alongside the company, or where parallel proceedings (such as regulatory investigations or criminal proceedings) are ongoing and directors and officers are also seeking cover under the D&O programme for their own defence costs.

Companies should check whether their Side C cover shares a single limit with Sides A and B and stress-test with their broker whether that limit is appropriate. They should also review whether the policy contains any provisions to determine how policy limits are allocated between the company and directors and officers where multiple insureds are seeking cover simultaneously.

3. **Understand policy notification requirements:** D&O policies (including Side C cover) are written on a "claims made" basis. This means that cover responds to claims first made during the policy period, regardless of when the underlying conduct occurred. This is important in the context of securities claims, which often crystallise years after the disclosures in issue. A claim brought during the current policy year may therefore relate to a disclosure made three, four or even five years earlier.

An important exception is where circumstances that may give rise to a claim are notified during a policy period. In that case, any subsequent claim arising from those circumstances will generally be treated as having been made during the policy year in which the notification was given. On the other hand, policies will often not respond to claims arising from circumstances of which the insured was aware but failed to notify or disclose under a prior year policy. Companies should therefore ensure that potential claims are identified and notified promptly to preserve coverage.

4. **Fraud and dishonesty exclusions should only apply on final adjudication:** Common exclusions include losses arising from fraud and dishonesty. Insureds should review their policies to confirm these types of exclusions are only triggered when there has been a final adjudication or admission of this conduct (as opposed to a mere allegation) and confirm that defence costs remain payable up to that point. Companies should also consider whether the policy contains any provisions regarding how employees' knowledge and conduct is to be attributed to the company, and ensure that it is limited to the knowledge and conduct of only senior management.

In summary, Side C cover fills a specific and increasingly important gap in a UK-listed company's insurance programme. It is typically the only part of the D&O structure that responds to the company's own liability to third parties. Listed companies should confirm whether their programme includes Side C cover, understand how the applicable limits are shared with Side A and Side B cover, assess whether those limits are adequate, and review both the notification provisions and fraud/dishonesty exclusions to ensure the intended protection will be available when needed.



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