# PE

# Private Equity

## Q&A

### What and Who Are Covered?

When securing GPL insurance, it is extremely important to identify to the insurance broker and underwriter the kinds of entities that need to be covered, to explain the relationships of those entities among one another and to the portfolio companies, and to discuss who the individual insureds must be. Then, those entities and relationships should be covered through express provisions in the GPL insurance that reflect those particular risks. The defined terms in the GPL policy should be modified so that they are specifically applicable to the private equity firm.

Unfortunately, many brokers and insurers in the market still do not fully understand private equity structures or their business. Some private equity firms end up with mutual fund, venture capital, or D&O insurance, each of which is fundamentally and legally different from GPL insurance. Also, many hedge funds end up with a limited policy form that doesn't provide adequate coverage for those particular investments that are more akin to private equity. The most common problem is that certain entities within the firm structure are not even covered by such policies. Even with significant modification, it is nearly impossible to change these policy forms to properly cover the risks associated with private equity structures and investing. At least with a GPL policy form as a starting point, the required modifications are usually fairly straightforward. For example, the definition of "insured" still needs to be modified to cover the relevant private equity funds, general partners (including foreign, onshore, and offshore entities) and managers. If there are co-investment entities, including those which are used to facilitate, among other things, the principals' estate planning, those entities are usually not covered unless they are specifically included by definition. With appropriate revisions, coverage may also be extended to non-principal professional employees, such as advisers or consultants. Most of these structural modifications are done to a GPL policy for no additional premium.

### What Key Risks Can Be Covered?

In the market there is a wide variety of policy forms, terms, and coverage offered. Coverage ranges from "above average" to "not worth buying" – so let the buyer beware. The standard "off the shelf" GPL policy is a good starting point, but is never adequate. Because each private equity firm differs in structure and business focus, revisions to the "off the shelf" form are always necessary. If drafted appropriately, GPL insurance can provide coverage for most risks associated with the business and the related investment activities. Generally, internal risks relating to limited partner litigation and employment litigation are covered. Also, with some careful drafting and negotiation, external risks such as securities claims, outside director liability claims (where fund representatives are serving as portfolio company directors or officers, for instance), public offering claims, controlling shareholder claims, and suits by buyers, targets, and their management can be covered. GPL policies can also cover certain compliance risks, such as Securities and Exchange Commission and Department of Justice investigations that may arise from time to time.

**These scenarios are not intended to be interpreted as coverage positions. Coverage for any given claim is based upon its facts and the specific terms and conditions of the policy.**

### What are other issues to look for?

Careful review of the proposed GPL policy and all of the endorsements is warranted, including the definitions, requirements for coverage, and exclusions as they apply to the manager, general partner, fund, and its principals. Insurers, through narrow definitions or express exclusions, usually try to exclude or severely limit coverage for government investigations and deal litigation. Private equity firms need to be on high alert, because without coverage for these significant exposures, individuals and the fund are at risk. Upon the insured's request, many insurers will modify language to address these particular risks. In fact, any provisions that don't fit the private equity firm's particular needs should be negotiated, and any ambiguous language should be clarified through endorsement. It is also important to obtain specific comfort from the insurer regarding the interpretations that will be applied in a particular context to ensure that coverage will be provided when it is needed.

In addition to negotiating manuscripted language to cover the business activities of the particular firm, there are certain exclusions and coverage enhancements that the insured should push for with the insurer. GPL policies generally exclude claims brought by or on behalf of one insured against another insured, subject to certain exceptions (such as shareholder derivative actions.) This is commonly referred to as the "insured vs. insured" exclusion. Since the limited partners are, of course, partners of the fund and could, therefore, be deemed an "insured" under firm GPL insurance, this may exclude from coverage claims by the limited partners against the general partner or manager, particularly if the suit is brought as a derivative action in the name of the fund. In such instances, the insured vs. insured exclusion should be modified to cover these risks, along with others relating to employment practices claims, foreign claims, and claims relating to a change in control, among others.

Another endorsement that should be negotiated relates to coverage for directors in the event of bankruptcy. This is particularly important coverage when a portfolio company investment does not turn out as planned. In the case of bankruptcy, in order to maintain the GPL policy for the benefit of the private equity firm and those individuals that serve on the portfolio company board, express language must be included in the GPL policy to make sure those directors are immediately covered in the event the portfolio company is financially unable to indemnify them. In addition, suits brought by a bankruptcy trustee or creditors' committee against the directors or private equity firm should expressly be included as covered.