Coronavirus: Factors for the Insurance Industry to Consider – Part 4 Directors & Officers (D&O) Insurance

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Wednesday, March 18, 2020

Given the risk to life and the economic impact of the COVID-19 pandemic, policyholders and the insurance industry alike are monitoring and assessing whether certain insurance benefits, including business interruption or event cancellation benefits, are available, while similarly assessing liability risks under various types of insurance policies, including directors and officers (D&O) insurance and workers’ compensation policies. This is the next installment in a series that will cover specific aspects of insurance that all stakeholders - insured, insurers and brokers - should consider. Read Part 1, Part 2, Part 3.
Coronavirus: Status and Impact

In response to the thousands of reported new cases of COVID-19 in countries around the globe, the World Health Organization (WHO) continues to monitor its Risk Assessment for China, Regional Level and Global Level as Very High (the highest risk level). Worldwide, there are more than 100,000 confirmed cases of the virus. According to the Centers for Disease Control and Prevention (CDC), as of March 16, 2020, the United States is now reporting 3,487 confirmed and presumptive positive cases across 49 states, the District of Columbia, Puerto Rico, Guam and the U.S. Virgin Islands.

Part 3 of this series touched on liability risks under various types of insurance policies. In this installment, we will take a closer look at D&O insurance factors that all insurance stakeholders should consider when claims under these policies are presented for coverage.

Directors & Officers Insurance

Response to the coronavirus has sparked volatility across world markets, caused by doubts as to whether the appropriate public health measures are being implemented and concerns over the full extent of impacts to global supply chains as the pandemic continues to create workforce and travel disruptions. Measures such as quarantines and travel restrictions are intended to manage the public health risk and are driven as well by economic factors such as reduced demand and concern for staff.

D&O insurance policies provide protection for company board members, executives and managers (and the companies they serve) from claims or investigations arising from their decisions and actions within the scope of their regular duties. However, company D&Os generally face increased scrutiny as securities class action filings approach record levels and settlement amounts increase, not to mention the rise in “event-driven” litigation in which securities suits are filed after an event, such as the COVID-19 pandemic, causing an unreasonable dip in a company's stock prices and increased shareholder derivative litigation. Ultimately, how a company responds to the rapidly changing coronavirus situation may subject its D&Os to the scrutiny of a wide range of claimants, including shareholders, competitors, customers, vendors, suppliers, employees and regulatory entities.

D&O Negligence and Fiduciary Duties

In general, D&Os may find themselves targets of claims that their decisions or actions or inactions taken in response to the coronavirus and/or market conditions created by the pandemic were negligent or a breach of their fiduciary duties to the corporation, such as the duty of care, which obligates D&Os to exhibit prudent judgment.

Lawsuits involving breach of fiduciary duty in connection with corporate disclosures is nothing new, especially in the context of securities litigation and derivative actions. According to Cornerstone Research, there were 428 federal court securities class actions filed in 2019, which was nearly double the 1997–2018 annual average of 215 filings. In such cases that name the D&Os as defendants, the alleged liability often focuses on failing to disclose material information or willfully providing
inaccurate information.

The federal Securities Act of 1933, particularly section 11, imposes a high standard of care on D&Os as to the accuracy of the disclosures in a public company’s Registration Statement for its securities offerings. Even a future director, who “with his consent, is named in the Registration Statement as being or about to become a director,” has the same responsibility for accurately disclosing information. (17 CFR section 230.438). D&Os can have strict liability for losses suffered by securities owners if the Registration Statement contains material misstatements or omissions on the date it becomes effective. The general anti-fraud provision of the 1934 Act, section 10(b), sets forth a general prohibition against the employment of deception in connection with the purchase or sale of securities. This anti-fraud provision covers almost any securities transaction, whether conducted face to face, over the counter or on national exchanges. The liability of directors and officers for fraud under section 10(b) depends on their participation in the transaction or their knowledge of the fraud.

An Early D&O Lawsuit
To that end, one of the first actions filed against a company’s CEO regarding alleged misstatements around the coronavirus is captioned *Patrick McDermid v. Inovio Pharmaceuticals, Inc., et al.* (20-cv-1402) filed in U.S. District Court, Eastern District of Pennsylvania. This matter, which was filed on March 12, alleges violations of section 10(b) of the 1934 Act / Rule 10b-5 and violations of section 20(a) of the Exchange Act. The complaint focuses on statements made by CEO J. Joseph Kim that Inovio had developed a vaccine for the coronavirus. Mr. Kim was quoted as saying “we were able to fully construct our vaccine within three hours,” which was later changed to advise that they had merely “designed a vaccine construct.” It is claimed that the alleged statements in the company’s Form 8-K regarding its vaccine to address COVID-19 were materially false and misleading, and upon a clarification of the disclosure the stock price dropped more than 71% in a two-day period. As against Mr. Kim, the plaintiff asserts that he had “the power and authority to cause or prevent the Company from engaging in the wrongful conduct complained of herein” and had “the ability to prevent the issuance of those materials or to cause them to be corrected so as not to be misleading. This case may be the tip of the iceberg in class action lawsuits premised on disclosures regarding the coronavirus in filings with the SEC.

Statutory Obligations Including Federal Securities Laws
The Securities and Exchange Commission (SEC) is monitoring the impact of coronavirus on investors and capital markets. SEC Chairman Jay Clayton, on March 4, 2020, issued a statement to remind companies to “provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments.” He also stated that companies “providing forward-looking information in an effort to keep investors informed about material developments, including known trends or uncertainties regarding coronavirus, can take steps to avail themselves of the safe harbor in section 21E of the Exchange Act for forward-looking statements.”

In response to a coronavirus-based loss in value, directors and officers may find
themselves targets of claims that the company disseminated false or misleading information or omitted material facts, such as risk factors of coronavirus, in required disclosures or failed to update disclosures, resulting in shareholder loss:

- In its annual report filed February 20, 2020, Yum! Brands, which operates Pizza Hut, Taco Bell and KFC, listed in its risk section that health concerns from coronavirus would significantly adversely impact its business due in part to temporary store closures in China and sales declines that also have hurt its suppliers.
- Procter & Gamble, which produces consumer goods, has announced that the COVID-19 pandemic and related store closures will have a material impact on its quarterly results overall and in China, its second-largest market.
- Apple and Microsoft both have updated prior quarterly guidance on the impact of coronavirus on supply chain and business operations.

**Actions Taken Regarding Safety**
There also are potential privacy-related issues in handling employees with coronavirus with respect to corporate policies that D&Os have enacted or the D&Os’ supervisory duties. Prior to coronavirus being declared a pandemic, there was a limitation under the Americans with Disabilities Act (ADA) as to what disability-related or medical inquiries could be made. For example, asking an employee to disclose a chronic health condition is a disability-related medical inquiry that is not permitted. Further, the disclosure of an employee’s illness also could be a violation of the ADA. Thus, D&Os have to be aware of the policies in place for the protection of their employees’ safety.

There also may be negligence claims in connection with D&Os’ performance of their duties that arise from failure to supervise their employees during this time period. Lawsuits against D&Os for failing to enforce their own human resources policies, and the allegations that the company’s public statements were materially false and misleading about those policies, have been made in the context of certain #metoo claims, including the lawsuit against Les Moonves of CBS (Samit v. CBS Corporation, et al., 18-cv-07796, (SDNY)). These types of lawsuits may provide the template that other securities complaints follow in connection with how a company handles personnel decisions involving the coronavirus.

**Statements Regarding Network Security**
An additional issue that may be the subject of litigation against D&Os in connection with the coronavirus concerns network security, as more and more companies are asking their employees to work remotely. In the context of cybersecurity breaches, D&Os have already been the subject of lawsuits regarding statements about their privacy security, as well as the data security of third-party service providers.

In the recent pending case captioned Minsky v. Capital One, et al., 19-cv-5593 (EDNY), a complaint was filed against Capital One, its CEO Richard Fairbank, and its CFO R. Scott Blackley, in connection with the company’s stock drop following the news of a cyber-breach. It is alleged that the D&Os made materially false and misleading statements regarding their cybersecurity protections, which heightened the company’s exposure to the cyber-attack. If D&Os are making disclosures regarding their employees’ ability to work remotely based on their offices being closed due to
the coronavirus and such information is inaccurate, these statements may lead to potential liability.

**Special Considerations of D&O Underwriting and Claims Handling**

When assessing the risk associated with liability related to the COVID-19 pandemic, insurers should consider:

- In the event of an extended economic downturn related to the pandemic, Side-A DIC (difference in condition) D&O Liability Coverage may be attractive to corporate managers who want added protection beyond corporate indemnification if their company becomes insolvent.

- Whether D&O insurance policies contain absolute bodily injury exclusions that expressly preclude coverage for any claim or loss “based on, directly or indirectly arising out of or relating to actual or alleged bodily injury,” even for economic loss. Of note, such exclusions continue to be challenged in the courts.

- Whether a policy applicant has a supply chain in areas impacted by or predicted to be impacted by the coronavirus, and whether risk factors are adequately addressed in the policy application.

- The implications that quarantines and travel restrictions may have on increased remote work, which could lead to potential cybersecurity threats and/or enforcement under data privacy regulations.

- Inclusion of endorsements or terms with specific coronavirus-related restrictions.

**Conclusion**

To prepare for the potentially catastrophic impact of a global pandemic or similar health crisis, policyholders and insurers should review D&O policies to determine:

- What new exposures and risks are present given the unique nature of the coronavirus?

- Are coverage changes needed?

- Which current policyholders are likely impacted most?

- Are we receiving early inquiries and claims, and, if so, what do they indicate?

- Do we have a process to triage claims to ensure they are handled in the best interest of all stakeholders?

The COVID-19 pandemic has created a lot of uncertainty in the world and it will likely have a larger impact than we currently foresee. There are certain companies that are more vulnerable than others, and companies have to take protective measures to further reduce their risk of being exposed. D&Os, as the leaders of their respective companies, are taking the initiatives to guide their employees through these tough times. However, the disclosures made by D&Os to the public and the
shareholders may become the basis of future liability. To prepare for the potentially catastrophic impact of a global pandemic, insureds, insurers and brokers must understand what is and is not covered under D&O policies, and should work together to minimize potential losses by evaluating potential claims as early as possible.

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National Law Review, Volume X, Number 78

Source URL: https://www.natlawreview.com/article/coronavirus-factors-insurance-industry-to-consider-part-4-directors-officers-do