



D&O Claims Grow Amidst the Coronavirus

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MONTHS OF GOVERNMENT-ORDERED closures and restrictions on U.S. businesses and requirements that consumers stay home to halt the spread of COVID-19 has taken its toll on the economy. While headlines have primarily focused on pressing issues regarding business interruption coverage, claims against directors and officers (D&O) in connection with COVID-19 have also been on the rise.

What distinguishes D&O liability insurance from other coverages regarding COVID-19 is the expansive range of D&O claims that may emerge. D&O coverage commonly provides, among others, the following main protections: Side A coverage, for the wrongful acts of directors and officers whom the company does not or cannot indemnify; Side B coverage, for reimbursement of the company's indemnification of its directors

and officers; and Side C coverage, for the company's wrongful acts. A wrongful act often is defined to include any breach of duty, neglect, error, misstatement, misleading statement, omission, or act of a director or officer, or the company.

D&O LIABILITY REGARDING COVID-19

Sales of securities provide the basis for many D&O claims concerning COVID-19. For example, shareholders have brought class actions against multiple companies alleging that they failed to inform shareholders of, and even downplayed, the significant impact of COVID-19 on business, including lawsuits against two different cruise lines. An animal supply company has been sued for its revenue downturn, purportedly based on changes in its distribution channel because of COVID-19. And a

recent class action against a Canadian cannabis company alleges that the company defaulted on its obligations under certain debentures by failing to make interest payments due to the impact of COVID-19 on the company.

Shareholders have also sued a company for falsely stating that it had developed a vaccine for COVID-19 when news that such reports were false resulted in a steep decline in the company's stock price. Similarly, a shareholder of Sorrento Therapeutics Inc. has filed a stock-drop suit alleging that the CEO's reference in mid-May on Fox News to a recent breakthrough in the company's COVID-19 treatment research as a "cure" artificially inflated the company's stock price.

Government enforcement actions relating to COVID-19 also have begun to arise. For example, the Securities and Exchange Commission (SEC) has



CLAIMS

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brought an action against a specialty finance company regarding its allegedly false and misleading press releases claiming that it was able to acquire and supply large quantities of N95 or similar masks to protect wearers from the COVID-19 virus. Federal and state law enforcement are likely to continue to bring similar actions as they develop a deeper understanding of the market impact of COVID-19. The SEC has formed a market monitoring group that reportedly will assist with, among other things, analyzing the effects of COVID-19 on markets, issuers and investors.

Companies' inadequate health and safety precautions to prevent the spread of COVID-19 has formed another basis for D&O claims. A wrongful death suit has alleged that Walmart failed to properly clean and disinfect the store, implement and promote social distancing, warn employees of the risks of COVID-19, or provide protective equipment to employees, which allegedly resulted in the death of an employee due to complications from COVID-19 that he contracted while

working at Walmart. A similar wrongful death action was filed against a cruise line company regarding the death of a passenger who allegedly contracted COVID-19 aboard the company's cruise ship. Government officials continue to discuss the possibility of immunity for health care providers from similar liability concerning COVID-19.

Antitrust violations have arisen concerning emergency and household supplies in connection with COVID-19. While governmental authorities have promoted cooperation to ensure the supply and distribution of scarce products and services that protect the health and safety of all consumers, they have also warned against collusion. Federal authorities in New York already have criminally charged individuals with price gouging and hoarding personal protective equipment during the pandemic.

Similarly, private consumer protection actions have been brought against companies such as Amazon and eBay alleging unfair business practices based on purported price gouging in connection with

COVID-19. The action against Amazon, for example, alleges that the company's sales in some categories, such as home items, have risen more than 1,000% in the wake of COVID-19.

In a related context, putative class actions have been filed against universities by students seeking to recoup their tuition for the periods in which the universities were physically closed due to COVID-19. Businesses that have been closed due to COVID-19 and continued to collect dues for access to a physical location, such as gyms or daycares, may face similar liability exposures.

Mismanagement claims may arise if a company fails to comply with employment-related rules and regulations. As the impact of COVID-19 forces businesses to take cost-saving measures such as layoffs, pay reductions and the like, D&O claims may arise regarding any failure to comply with the Worker Adjustment and Retraining Notification Act ("WARN Act"). The WARN Act imposes certain requirements on employers concerning closures and layoffs to "provide workers with

sufficient time to prepare for the transition between the jobs they currently hold and new jobs,” such as by providing advance notice to employees of layoffs or closings. For example, class actions have been filed against companies for violating the WARN Act by purportedly relying on COVID-19 to justify terminating workers on improperly short notice.

Wage and hour claims also may arise regarding decisions concerning layoffs, furloughs and unpaid wages. And fiduciary liability claims may be brought regarding benefits such as an employer’s stock-ownership plan, bonus systems and health, retirement and other benefits plans.

Further, D&O claims may result from an alleged failure to develop policies addressing employees with a COVID-19 diagnosis or based on a whistleblower’s report of failure to comply with regulations and guidelines concerning COVID-19. Claims may also result as employees begin returning to the workplace and claim that their employers have not instituted adequate policies and procedures to ensure the workplace adequately protects employees’ health and safety.

Moreover, False Claims Act liability exists as companies seek governmental relief based on COVID-19, such as by submitting claims under the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”). The CARES Act provides, among other things, government assistance programs to small businesses affected by the COVID-19 epidemic. Companies that knowingly make false claims to the government to obtain money or property may be assessed damages and penalties under the False Claims Act in an action brought by the government or by a whistleblower on behalf of the government.

For example, likely to avoid False Claims Act liability, Shake Shack recently returned its \$10 million loan under the CARES Act, which it had applied for purportedly based on the misunderstanding that such relief applied to employers with fewer than 500 employees *per location*, and not fewer than 500 employees *total*.



D&O COVERAGE REGARDING COVID-19

While a variety of D&O coverage issues might arise under a given policy concerning a particular claim, a common provision that may broadly apply in this context is the exclusion for loss in connection with any claim for bodily injury, property damage or personal injury (BI/PD exclusion).

Concerning bodily injury, the BI/PD exclusion typically precludes coverage for bodily injury, mental anguish, emotional distress, sickness, disease or death of any person. Such exclusions may preclude coverage for D&O claims that are based on the alleged mismanagement or breach of fiduciary duty of companies’ measures to prevent the spread of COVID-19.

As to property damage, the BI/PD exclusion often excludes coverage for damage to or destruction of any tangible property, including loss of the property. As such, coverage may not be available for any “claim” concerning a “wrongful act” that resulted in property damage from COVID-19. This issue may be informed by the ongoing litigation concerning whether COVID-19 can cause

“direct physical loss of or damage to” property in the context of business interruption coverage.

Additionally, while a D&O policy may contain a bankruptcy exclusion that excludes coverage for claims arising out of insolvency or bankruptcy, certain other coverage issues tend to arise in bankruptcy. Many large companies have filed for bankruptcy in recent months based on losses from COVID-19. Notwithstanding any shareholder lawsuits that such bankruptcies may spur, complicated issues may arise regarding the amount of insurance available, as among multiple claims and between the company and its directors and officers; whether the insurance policy or its proceeds constitutes property of the debtor’s estate; and whether the insurers must seek the bankruptcy court’s approval to make any payments, including for the defense of directors and officers who are not parties to the bankruptcy.

As the spread of COVID-19 continues to impact businesses’ bottom lines, directors and officers will continue to have broad liability exposure to shareholders, stakeholders, employees and the government. The issues discussed here provide only a broad outline of the various complex liability and coverage issues that may continue to develop during, and perhaps long after, the spread and containment of COVID-19.

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