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A commentary article reprinted from the May 7, 2020 issue of Mealey's Emerging Insurance Disputes

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Commentary

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The impact of the coronavirus (COVID-19) on United States businesses is mounting by the day and may not be fully realized for some time. As continued shelter-in-place orders issued across the U.S. have forced closures and limitations on businesses across a wide range of industries, giving rise to a variety of risks to the directors and officers of those businesses, such matters inevitably will lead to claims that are likely to be tendered to directors and officers (D&O) insurers. This article focuses on some of the types of claims that may arise and provides practical considerations for D&O insurers.

I. Shelter-in-Place Orders

More than 316 million people in the U.S., in at least 42 states and the District of Columbia, are reported to be under some form of shelter-in-place order aimed at impeding the spread of COVID-19.[1] While the particular requirements and restrictions of such shelter-in-place orders vary, virtually all have required "non-essential" businesses to close and have imposed certain health and safety measures on "essential" businesses that are permitted to remain open.[2] As discussed more fully below, such restrictions continue to breed wide-ranging liability risks for directors and officers.

II. D&O Liability Relating to COVID-19

D&O claims relating to COVID-19 are likely to concern allegations regarding, among other things, inadequate disclosures in the sales of securities, mismanagement over health and safety precautions, antitrust violations, inadequate management leading to financial failure, improper procedures with respect to the termination of employment/closing of facilities, and/or false or misleading statements in submissions for government relief.

A. Securities Claims

As the restrictions imposed by shelter-in-place orders continue to impact the bottom line of many businesses, lawsuits have begun to arise regarding companies' alleged failure to disclose the impact of COVID-19 on business. In the first quarter of 2020, the total potential exposure as a result of securities class actions directly relating to COVID-19 reportedly was approximately $2.7 billion, or 4.32% of the total Rule 10b-5 exposure in the U.S.[3]

The first of such cases was a federal securities putative class action filed on March 12, in *Douglas v. Norwegian Cruise Lines, et al.*, No. 1:20-cv-21107-XXX (S.D. Fla. Mar. 12, 2020), where the plaintiff shareholders of a cruise-line company seek to recover damages based on their purchase of "artificially inflated" stock. Specifically, the *Douglas* plaintiffs allege that the company failed to inform and misled shareholders regarding the significant impact of COVID-19 on the company's profits since December 2019, which include "canceled trips and half-empty ships." They focus on a February 20, 2020 press release presenting what plaintiffs describe as "positive outlooks" despite the outbreak and seek certification of a February 20, 2020 through March 12, 2020 class period.

On the same day that *Douglas* was filed, another federal securities putative class action was filed against a biotechnology company in connection with COVID-19, in *McDermid v. Inovio Pharmaceuticals, Inc., et al.*, No. 2:20-cv-01402-GJP (E.D. Pa. Mar. 12, 2020). The *McDermid* plaintiffs allege that the company, which purportedly develops medicines to treat, cure, and/or protect people from infectious diseases, publicly announced that it had developed a vaccine for COVID-19, resulting in substantial increases in the company's stock price. However, when it was later publicly revealed by a stock-commentary website that the biotech company had not developed such a vaccine, its stock price steeply declined.[4]

On April 7, a federal securities putative class action was filed against the video communications platform application Zoom, in *Drieu v. Zoom Video Communications, Inc., et al.*, No. 5:20-cv-02353 (N.D. Cal. Apr. 7, 2020). The action alleges that Zoom failed to inform and misled shareholders that, among other things:

> (i) Zoom had inadequate data privacy and security measures; (ii) contrary to Zoom's assertions, the Company's video communications service was not end-to-end encrypted; (iii) as a result of all the foregoing, users of Zoom's communications services were at an increased risk of having their personal information accessed by unauthorized parties, including Facebook; (iv) usage of the Company's video communications services was foreseeably likely to decline when the foregoing facts came to light; and (v) as a result, the Company's public statements were materially false and misleading at all relevant times.

The plaintiffs allege that, while such inadequacies in Zoom's platform began to come to light in July 2019, the inadequacies did not fully come to shareholders' attention until businesses and other organizations began increasingly relying on Zoom's product to facilitate remote work activity amid the COVID-19 outbreak. In March 2020, when Zoom announced that Facebook had been collecting information from Zoom users that was "unnecessary for [Zoom] to provide [its] services," through a Facebook plugin in Zoom's software that enabled users to login to Zoom through Facebook, Zoom's share price fell.

COVID-19 related securities actions also have begun to arise in the international context, such as in the lawsuit filed on April 24, 2020 by a shareholder against a Chinese real estate firm whose American Depositary Shares ("ADSs") are listed on the New York Stock Exchange, in *Wandel v. Gao, et al.*, No. 1:20-cv-03259 (S.D.N.Y. Apr. 24, 2020). The shareholder alleges that she purchased ADSs from the real estate company in connection with the company's IPO on January 17, 2020, and that the company violated securities laws regarding such sale of ADSs by omitting and misrepresenting the nature and level of renter complaints the company had received before and at the time of its IPO – particularly in Wuhan – based on the spread of COVID-19.

Other D&O risks concerning securities might exist as COVID-19 continues to impact stock prices. For example, in times such as this, business leaders may be drawn to turn to social media to, among other things, encourage and inspire shareholders and stakeholders regarding the future of the company. However, as we learned with Tesla CEO Elon Musk's August 7, 2018 post on Twitter, that he was "considering taking Tesla private at $420. Funding secured," social media presents a significant risk to directors and officers.[5] In this regard, shareholder suits based on a variety of factors relating to COVID-19 may continue to arise.

Additionally, on April 28, 2020, the Securities Exchange Commission filed its first COVID-19 related enforcement action, in *SEC v. Praxsyn Corp., et al.*, No. 9:20-cv-80706-XXXX (S.D. Fla. Apr. 28, 2020). The action alleges that Praxsyn, which is a specialty finance company providing cash flow solutions and medical receivables financing to healthcare providers, "issued false and misleading press releases claiming that Praxsyn was able to acquire and supply large quantities of N95 or similar masks to protect wearers from the COVID-19 virus." Enforcement actions of this kind and others relating to COVID-19 are likely to continue to arise as the SEC focuses on the impact of COVID-19 on the market. For example, the SEC has announced its formation of "an internal, cross-divisional COVID-19 Market Monitoring Group," which reportedly will assist the SEC in (1) analyzing the effects of COVID-19 on markets, issuers, and investors, and (2) responding to requests for information, analysis and assistance from fellow regulators and other public sector partners.[6]

B. Operations Mismanagement and Fiduciary Liability Claims

The extent to which companies take or fail to take precautions with respect to the spread of COVID-19 also may serve as the basis for D&O claims.

For example, the first wrongful death suit related to COVID-19 would appear to be the action brought against Walmart on April 6, in *Evans v. Walmart, Inc., et al.*, No. 2020L003938 (Ill. Cir. Ct., Cook Cty. Apr. 6, 2020). *Evans* alleges that the 51-year-old decedent was an employee of Walmart who passed away due to complications from COVID-19, which the decedent purportedly contracted during his employment at a Walmart Supercenter. The action alleges that Walmart failed to take proper precautions with respect to the spread of COVID-19 by, among other things, failing to properly clean and disinfect the store, implement and promote social distancing, warn employees of the risks of COVID-19, and/or provide protective equipment to employees.

A similar suit was filed against a cruise line on April 14, in *Dorety v. Princess Cruise Lines Ltd.*, No. 2:20-cv-02458 (C.D. Cal. Apr. 14, 2020). *Dorety* alleges that the decedent passenger of one of the company's cruises died from COVID-19 after contracting the virus on the cruise. The plaintiff alleges that she and her husband, the decedent, boarded the cruise on February 21, 2020 without knowledge that at least two of the cruise's passengers had symptoms of COVID-19. After several days at sea, the cruise began removing buffets and condiments, and required employees to wear gloves. Eventually, the cruise cancelled entertainment such as shows, but continued to hold community events such as bingo. After two weeks, the cruise quarantined guests to their rooms. After contracting COVID-19, the decedent eventually was taken off ship to a hospital, where he died days later.

Similar claims may yet arise across industries and professions that have been deemed "essential" and have remained open throughout the spread of COVID-19. For example, while no lawsuit appears to have arisen yet in this regard, news sources have reported that hundreds of health workers working at the same hospitals have tested positive for COVID-19.[7] Liability in this context also has begun to arise regarding senior living facilities, such as where a wrongful death suit has been brought in connection with 37 deaths from COVID-19 associated with one such facility in Seattle.[8]

C. Antitrust and Consumer Protection Claims

Governmental authorities, such as the U.S. Department of Justice and the Federal Trade Commission, have made clear that antitrust violations in the wake of COVID-19 are a focus of law enforcement and will be pursued.[9] At the same time, the government has relaxed antitrust measures in some regards, such as by working expeditiously to process filings under the Standards Development Organization Act regarding joint ventures and by promoting collaboration on research and development, the sharing of technical know-how, partnering in the development of standards for patient management, joint purchasing arrangements among healthcare providers, and the lobbying of federal government regarding strategies for responding to COVID-19.[10]

Similarly, the International Competition Network has framed the issue as follows:

> The COVID-19 pandemic has prompted concerns that, while most businesses will act responsibly, some businesses might respond with anti-competitive conduct, e.g., by cartelizing or abusing a dominant position. It is of utmost importance to ensure that products and services remain available at competitive prices, especially those that are essential to urgent public health needs in the current situation, like medical supplies and equipment. Competition agencies intend to remain vigilant against anti-competitive mergers or conduct during this crisis. This extraordinary situation may trigger the need for competitors to cooperate temporarily in order to ensure the supply and distribution of scarce products and services that protect the health and safety of all consumers. Such joint efforts, if limited in scope and duration necessary to assist

> those affected by COVID-19, and in line with applicable laws or specific guidance from authorities, may be a necessary response to protect consumers and provide products or services that might not be available otherwise. It can be appropriate for competition agencies to accommodate collaboration between competitors necessary to address the circumstances of the crisis to the extent that their laws permit.[11]

Nevertheless, opportunistic companies that exploit the pandemic for economic gain will not be spared. The government's mantra in this regard has been characterized as "coordination, not collusion."[12] The acts of companies, and their directors and officers, that can be characterized as falling on the side of collusion may face a government investigation and possibly prosecution. For example, federal law enforcement in New York have charged individuals with price gouging and hoarding personal protective equipment in connection with COVID-19.[13]

Private actions regarding consumer protection have begun to arise in a related context. On April 21, 2020, a putative class action by consumers was filed against Amazon, in *McQueen, et al. v. Amazon.com, Inc.*, No. 4:20-cv-02782 (N.D. Cal. Apr. 21, 2020), alleging violations of California's Unfair Competition Law, unjust enrichment, and negligence based on purported price gouging in connection with COVID-19. The plaintiffs allege, among other things, that "Amazon's sales have never been higher, and since the COVID-19 pandemic began, its sales in some categories (*e.g.*, home items) are ***up more than 1,000 percent*.**" Actions of this kind may continue to arise against retailers.

Another type of consumer claims have arisen in the context of demanding refunds for purportedly unearned payments. Specifically, multiple 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, including at Fordham University, Vanderbilt University, the Regents of the University of California, and the Board of Trustees of the California State University.[14] Such actions allege causes of action including breach of contract, unjust enrichment, and conversion. Actions of this kind may continue to arise not only as to universities but, more broadly, with respect to businesses for which patrons typically pay for access to a physical location, such as gyms, country clubs, and daycares, which may be continuing to accept payments during closures of such physical locations due to COVID-19.

D. Bankruptcy & Financial Mismanagement Claims

As stock prices have tumbled, billions of dollars in collective market capitalization has been lost, and it is unfortunately inevitable that some companies will not survive the closure of their locations and facilities. The popular apparel company, True Religion, filed for Chapter 11 bankruptcy protection on April 13, citing financial challenges due to prolonged closure of its brick-and-mortar stores because of COVID-19.[15] There also have been reports that other retail giants such as JCPenney, Lord & Taylor, Centric Brands Inc., and Neiman Marcus also are considering seeking bankruptcy protection in connection with COVID-19 closures.[16] As was seen during the 2008 and 2009 Financial Crisis, such filings often are followed by lawsuits against the directors and officers of the failed company.[17]

In addition to any shareholder lawsuits that may result from a bankruptcy, the bankruptcy itself tends to raise complicated issues regarding D&O coverage. For example, disputes commonly arise regarding the amount of insurance available – as among multiple claims and as between the company and its directors and officers. Litigation also might arise regarding whether the insurance policy constitutes property of the bankrupt estate of the company under Bankruptcy Code Section 541(a) and, as such, whether any payment of those insurance proceeds is subject to the automatic stay under Bankruptcy Code Section 362, and whether insurers are required to seek bankruptcy court approval to make those payments, even to pay for the defense of directors and officers who are not in bankruptcy.[18]

E. Employment Claims

Companies are being forced to make significant decisions with respect to their employees on a day-to-day basis. Layoffs, furloughs, salary cuts, deferred compensation, and other actions are in the news each day. In addition to the existing local, state, and federal regulations that govern employers' decisions in this regard, various authorities additionally have issued regulations and guidelines specific to COVID-19. For example, the U.S. Department of Labor Occupational Safety and

Health Administration has published the "Guidance on Preparing Workplaces for COVID-19," available at https://www.osha.gov/Publications/OSHA3990.pdf. A failure to comply with any such regulations or guidelines may provoke regulatory and liability exposure for directors and officers.

Relatedly, directors and officers may face liability exposure for any failure to comply the Worker Adjustment and Retraining Notification Act (WARN Act), which imposes certain requirements on employers with respect to closures and layoffs to "provide workers with sufficient time to prepare for the transition between the jobs they currently hold and new jobs."[19] In this regard, the WARN Act requires a business, under certain circumstances, to provide advance notice to employees of layoffs or closings. For example, in the putative class action filed on April 3, *Siers v. Velodyne LiDAR, Inc.*, No. 5:20-cv-02290-NC (N.D. Cal. Apr. 3, 2020), the plaintiffs allege that the company improperly used COVID-19 as an explanation for already planned employment actions to eliminate large numbers of jobs on improperly short notice. A similar putative class action was filed on April 16 against Hooters, in *Scott, et al. v. Hooters III, Inc.*, No. 8:20-cv-00882 (M.D. Fla. Apr. 16, 2020), where the plaintiffs seek 60-days compensation and benefits for violations under the WARN Act.

Directors and officers may face liability exposure also based on any decision to terminate certain employees due to a COVID-19 diagnosis or a whistleblower's report of any failure to comply with regulations and guidelines concerning COVID-19. Additionally, wage and hour claims may arise with respect to any decisions concerning, for example, layoffs, furloughs, and unpaid wages. Such employment decisions also may impact other issues bearing on fiduciary liability, such as an employer's stock-ownership plan, bonus systems, and health, retirement, and other benefits plans.

F. False Claims Act Claims

D&O liability risks might also arise as companies begin seeking governmental relief in connection with COVID-19. On March 27, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law.[20] The CARES Act provides, among other things, government assistance programs to businesses affected by the COVID-19 epidemic. For example, under Section 1102.7(a) of the CARES Act, small businesses may qualify for certain business interruption loans, provided they meet certain conditions. The disbursement of funds under the CARES Act will be overseen by the U.S. DOJ.

Under the False Claims Act, any business that makes false claims to the government, with knowledge of the claims' falsity, in order to obtain money or property may be subject to damages and penalties.[21] An action under the False Claims Act may be brought by the government or by a whistleblower on behalf of the government, which is referred to as a *qui tam* action. In this regard, the popular burger chain, Shake Shack, has returned its $10 million loan under the CARES Act, which the CEO has stated that the company initially understood to apply to employers with no more than 500 employees *per location*, and not 500 employees *total*.[22] As companies continue to file claims for relief under the CARES Act and any similar state-level relief as may come into effect, D&O liability exposure may arise with respect to any knowingly false statements made to the government in connection with such requests for relief.

III. D&O Liability Coverage Issues Relating to COVID-19

A typical D&O insurance policy provides the following main types of protection:

> Side A coverage, which protects individual directors and officers when the company does not (or cannot) indemnify them by law, for public policy reasons, or due to financial insolvency; Side B coverage, which protects the company by reimbursing the company for amounts it pays to indemnify its directors and officers; and Side C coverage, which protects the company for its own wrongful acts.

As noted above regarding the bankruptcy context, coverage issues often arise as to how to allocate limited policy proceeds among multiple insureds, including between the company and its directors and officers. D&O insurance policies tend to include an order-of-payments provision, under which payments on behalf of the directors and officers under Side B coverage may be prioritized over payments on the company's behalf under Side C coverage. Additionally, in the event that the company has purchased separate Side A coverage that can be accessed only by the company's directors and officers, such coverage typically sits excess above any coverage that the director or officer may have under the Side A or Side B coverage available under the company's traditional D&O policy.

D&O claims relating to COVID-19 may, of course, raise common coverage issues under the policy, such as notice and reporting provisions, the definition of "insured," the definition of a "claim," and the definition of a "wrongful act," to name only a few. Under the circumstances, insureds may be particularly vigilant with regard to any need for coverage and, therefore, might tender a matter before any "claim" – commonly defined to include a written notice or demand for monetary or non-monetary relief – has been made. In such instance, the insured's tender may constitute notice of a circumstance that could give rise to a "claim," even though no "claim" has yet been made, presuming that there has been compliance with the requirements of such notice.[23] Additionally, certain exclusions commonly included in D&O liability policies may preclude coverage.

Novel coverage issues specific to COVID-19 might also arise under certain exclusions that are commonly included in D&O liability policies. For example, many such policies contain an exclusion for loss from a claim for bodily injury, property damage, or personal injury (BI/PD Exclusion). The bodily injury portion of the BI/PD Exclusion commonly precludes coverage regarding bodily injury, mental anguish, emotional distress, *sickness, disease, or death of any person*. This exclusion is likely to be raised as a coverage defense in many of the D&O claims that arise in connection with COVID-19 based on the alleged mismanagement and/or breach of fiduciary duty with respect to companies' precautions, or lack thereof, concerning the spread of the virus, as alleged in the *Evans* and *Dorety* cases discussed above.

Further, the property damage portion of the BI/PD Exclusion commonly excludes coverage for damage to or destruction of any tangible property, including the loss of such property. This exclusion sets a D&O liability policy apart from a commercial property policy. To the extent that any "claim" concerns a "wrongful act" that is alleged to have resulted in property damage from COVID-19, the BI/PD Exclusion may apply. Note, however, that the debate as to whether COVID-19 can cause property damage continues to play out in the context of business interruption coverage under a property policy.[24]

Another exclusion that may apply with regard to securities actions is an exclusion that precludes coverage for violations of the Employee Retirement Income Act of 1974 and any similar laws regarding the administration of employee benefits (ERISA Exclusion). As discussed above, COVID-19 has resulted in significant losses to businesses and corresponding changes in stock prices; in turn, ERISA class actions alleging the mismanagement of retirement funds may arise. However, coverage likely would not be available for such actions under a D&O liability policy that contains an ERISA Exclusion, unless that policy also provides fiduciary liability coverage.

In the employment context, D&O policies frequently include exclusions for employment-related claims, such as those regarding any termination, discrimination, harassment, or retaliation, and for claims regarding wage and hour violations. Such exclusions may apply to the extent that any "claim" is made against a director or officer regarding certain employment decisions concerning COVID-19, such as the decision to furlough or layoff employees, or to reduce or defer compensation. These exclusions also should be evaluated with respect to any claim that may arise regarding alleged discrimination against an employee based on a COVID-19 diagnosis.

Finally, COVID-19 -related D&O liability exposures should be carefully considered by insurers when evaluating applications for renewal policies. Due to the widespread impact of COVID-19, and the broad range of the types of claims that may arise in connection with the virus, an insured may not yet be aware of claims on the horizon. The general circumstance of the COVID-19 outbreak, on its own, may not constitute a circumstance that may result in a "claim" against the insured, without some further analysis of why that particular insured might reasonably expect that a claim will result. However, insurers should carefully investigate the matter, including the timeline of events and communications by the insured that may provide insight as to whether and to what extent the insured might reasonably have been aware of specific circumstances that might have resulted in a "claim" against the insured. Additionally, in determining premiums, insurers might be attuned to changes in insureds' balance sheets from before, during, and after, the COVID-19 outbreak, which may reflect a more distressed or unbalanced financial position than the insured might have had before the pandemic. It will be increasingly important in the wake of the pandemic for underwriters to be attuned to additional risks that may result on a renewal policy, or on a new application for coverage.

IV. Conclusion

The COVID-19 outbreak is likely to impose continued, widespread financial ramifications on businesses. Directors and officers have broad exposure in this regard, including as to investors and the government with respect to the company's statements and disclosures, as to stakeholders in taking precautions to avoid the spread of COVID-19, and as to the public-at-large to avoid engaging in unfair and anti-competitive business practices. In the coming months, D&O insurers are likely to see more and more claims relating to COVID-19, in a variety of contexts.

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20. S.B. 3548, 116th Congress 2019-2020 (U.S. 2020), https://www.congress.gov/bill/116th-congress/senate-bill/3548/text?q=product+update (last visited Apr. 19, 2020).

21. 31 U.S.C. § 3729, *et seq.*; U.S. Dep't of Justice, *The False Claims Act: A Primer* (Apr. 22, 2011), https://www.justice.gov/sites/default/files/civil/legacy/2011/04/22/C-FRAUDS_FCA_Primer.pdf (last visited Apr. 17, 2020).

22. Bill Chappell, *Shake Shack Returns $10 Million Loan To U.S. Program For Small Businesses*, NPR (Apr. 20, 2020), https://www.npr.org/sections/coronavirus-live-updates/2020/04/20/838439215/shake-shack-returns-10-million-loan-to-u-s-program-for-small-businesses (last visited Apr. 21, 2020); Randy

Garutti, *Shake Shack is returning its PPP Loan. Here's why:*, LinkedIn (Apr. 19, 2020), https://www.linkedin.com/pulse/shake-shack-returning-its-ppp-loan-heres-why-randy-garutti/?trackingId=DcPf5So0Ruy1gE9qXEdmAA%3D%3D (last visited Apr. 21, 2020).

23. We already have seen, for example, prophylactic notices providing generic notices of closures and economic impacts.

24. For a discussion regarding issues pertaining to business interruption coverage in connection with COVID-19, see Tony Jones, Jennifer Mathis and Michael Huggins, *The Key Coverage Issues Regarding Business Interruption From COVID-19*, Mealey's Litigation Report: Insurance (Apr. 15, 2020), https://www.lexislegalnews.com/mealeys-insurance/articles/49662/commentary-the-key-coverage-issues-regarding-business-interruption-from-covid-19 (last visited Apr. 19, 2020). ■

MEALEY'S: EMERGING INSURANCE DISPUTES
edited by Jennifer Hans
The Report is produced twice monthly by

LexisNexis®

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Web site: http://www.lexisnexis.com/mealeys
ISSN 1087-139X