# In the Firing Line:
# Directors' and Officers' Liability and the COVID-19 Pandemic

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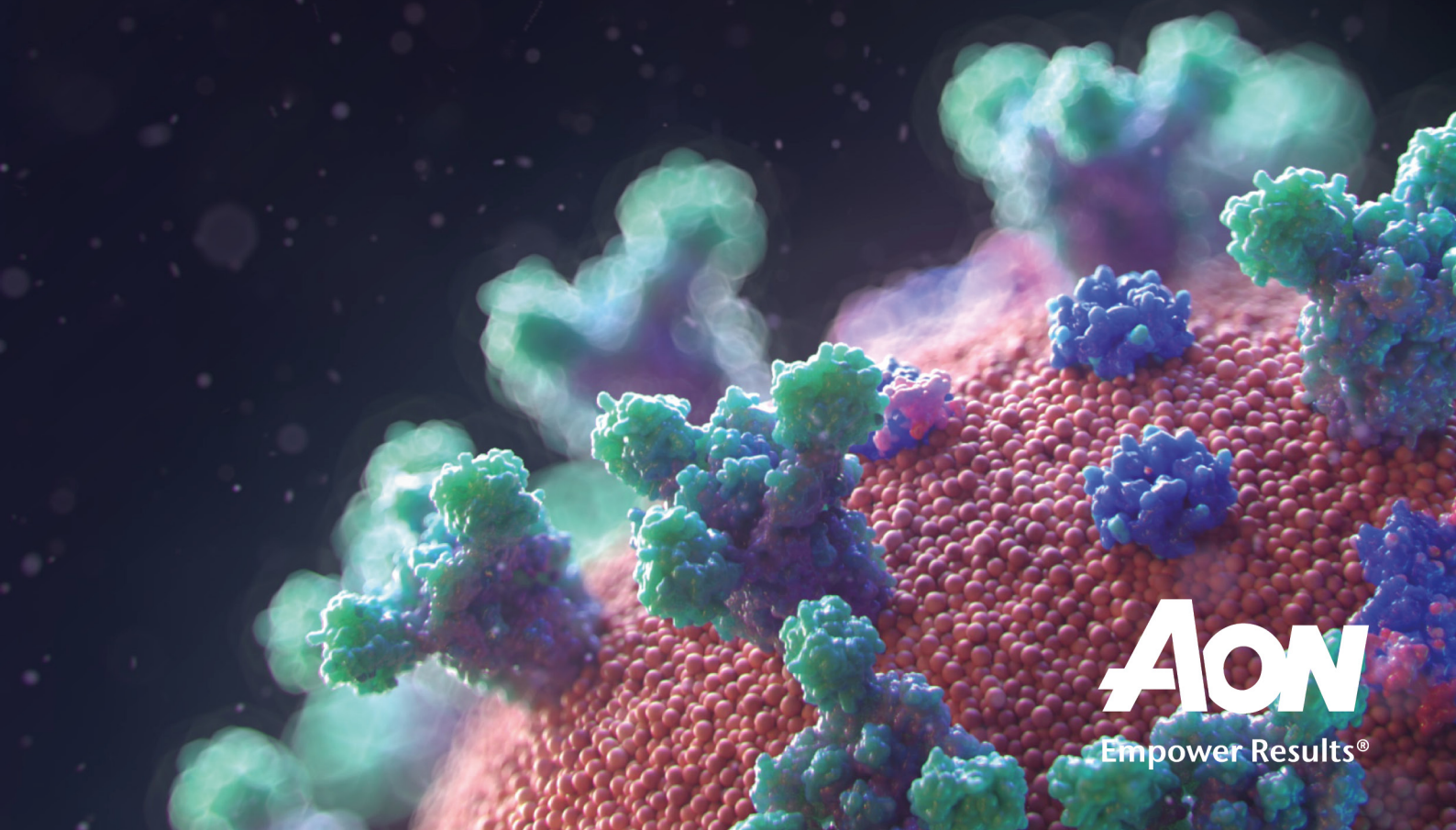

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# In the Firing Line: Directors' and Officers' Liability and the COVID-19 Pandemic

It is an anxious time for all businesses coping with the COVID-19 pandemic. In recent years, we have seen a wave of unrelated "event-driven" D&O claims, arising from the likes of #MeToo, cyber incidents, and a variety of high profile accidents. Climate change related D&O claims may not be far away. Given this, it is not hard to imagine how a global pandemic and a corporation's management or perceived mismanagement, including its corporate disclosures, could result in a D&O claim. Given the unprecedented events rapidly unfolding, whether such a claim would be successful is another matter.

## Disclosures

At the time of writing, social media sources have already reported two US securities claims relating to public statements made by companies in relation to COVID-19. Are these cases outliers or the beginning of a trend? As they arose from the cruise and pharmaceutical industries, which are closely connected to the fallout from COVID-19, it is not altogether surprising they were filed. Claims are anticipated in other industries that are closely affected too, and possibly others.

Investors (and the plaintiffs' bar) will be watching closely as companies and their directors make announcements about the effect of COVID-19 on their business models. Clearly, companies and their directors cannot be liable just because the virus has a business impact: it came out of the clear blue sky and will impact every business in some way. It is what they say about the likely impact of the virus and the measures being taken to mitigate it that may give rise to a brush with securities laws. Companies will need to take great care in drafting communications about the virus and its possible consequences, particularly given this is a quickly developing situation with constantly changing horizons.

## Mismanagement

There is also the potential for mismanagement related claims against directors, namely, that the board was in breach of its fiduciary duties in failing to adequately address the risks and steer its company through the crisis with the least possible damage. In the UK, these would be framed as a breach of the duty to act with reasonable skill, care and diligence (Section 174, Companies Act 2006), and there are similar or equivalent duties in virtually every other jurisdiction. Such claims could be brought by companies themselves, or via the derivative action process (in which a single shareholder can bring a claim on behalf of the company), or by liquidators following an insolvency.

Of course, directors of all companies are coping with extremely challenging conditions and complex problems on a scale that has not been seen before. Honest mistakes will be made by people doing their best. Courts are likely to forgive directors if they can demonstrate they listened to the government or expert advice, and took reasonable and proportionate steps based on the state of knowledge at the time and considering the resources at their disposal. Courts will be less sympathetic to those who ignored, downplayed or grossly underestimated the significance of the virus based on the state of knowledge available, or unreasonably delayed taking action until it was too late.

A board that is able to show that it had a robust business continuity plan, took the threat seriously, weighed up all the issues, and made decisions accordingly is less likely to be vulnerable to judicial criticism when things subsequently still went wrong. Board minutes recording the discussions could be key. If found to have been in breach of duty, the UK Companies Act (Section 1157) allows the

courts to nevertheless relieve from liability any directors who acted “honestly and reasonably”. It is easy to see how this provision could be a focus in cases.

## The D&O policy

So, it’s by no means inevitable that directors will be liable if sued; there may be strong defences, and it will be important to access defence costs coverage and/or any available indemnification from the company to ensure they are fully deployed. A securities class action arising from false or misleading disclosures or a derivative suit alleging breach of fiduciary duties or corporate mismanagement of a COVID-19 driven event would be the type of claim expected to be covered under a D&O policy.

As with any insurance policy, the specific facts and allegations of any claim will dictate coverage. To be prepared, directors, officers and companies should proactively review their D&O insurance policies, in conjunction with their advisers, paying particular attention to any relevant exclusions and limitations. For example, although at the time of writing there is generally no exclusion specific to a COVID-19 event for D&O policies, we cannot rule out the possibility of this being requested by insurers in future renewal discussions.

In addition, D&O policies normally contain varying forms of a “bodily injury” exclusion limiting the extent of coverage for claims involving “bodily injury [other than emotional distress or mental anguish], sickness, disease, or death of any person, or damage to or destruction of any tangible property, including the loss of use thereof…”. The bodily injury exclusion is often narrowly framed so that it can only relate to direct injury claims of the type a GL policy would be expected to cover. This would be unlikely to adversely affect coverage for securities or mismanagement claims. Alternatively, it can contain specific “carve-backs” to the exclusionary language providing further clarity regarding the intent of the exclusion to not apply to securities claims, defence costs, or non-indemnifiable / Side A claims (among other things). Therefore, simply because a claim arises from, is based upon, or relates to bodily injury from the COVID-19 virus, coverage is unlikely to be automatically excluded. However, the actual language used will dictate the outcome.

The COVID-19 crisis will give rise to events that are covered under other corporate policies of insurance. Companies should be carefully examining these to check if and when they can make claims. Although not commonplace today, some D&O policies may contain a “failure to maintain insurance” exclusion. A failure of the company to maintain policies that could have mitigated losses for the company could be an obvious source of mismanagement claims against directors. Indeed, one of the leading UK D&O cases Re D’Jan of London, 1993, was a “failure to maintain insurance” case. If such an exclusion appears, it will be important to consider its implications.

There is some speculation that certain insurers may look to add an “insolvency exclusion” to D&O policies in certain specific sectors perceived to be more likely to have an increase in corporate insolvencies. We will be looking to minimise the impact of such a clause should it be introduced.

## Side A cover

Some final remarks should be made concerning the D&O programme structure and the purchase of Side A (non-indemnified coverage):

- The potential for mismanagement claims to be brought via a derivative action by a shareholder on behalf of the company is real. In general, it is believed that the severity of derivative suits is growing, as evidenced by recent US derivative claim settlements in the hundreds of millions of dollars. Directors of non-US companies that have US shareholders cannot assume they are immune to a US derivative lawsuit and can expect an expensive

jurisdiction contest before the claim even proceeds. In the UK, it has not often been the weapon of choice for shareholders, but this could change in extreme circumstances such as those we find ourselves in now. Failing that, in the UK and Europe, there could simply be an increase in "New Board v Old Board" claims, ie by companies against their former directors.

- Insolvencies will inevitably rise due to cashflow and supply chain issues, particularly among companies that were already in a weakened financial state before the pandemic. In Europe, insolvency is already a potent source of D&O claims. In the case of an insolvent company, there can be no company indemnification, and so D&O coverage is the primary source of protection.

In anticipation of either of the above events, insurance buyers would be well-advised, in particular, to review their Side A coverage (which is typically broader than a Side A/B/C policy).

## Conclusions

These are extraordinary times. The early signs are that companies and their directors will face D&O claims arising from the impact of COVID-19, from a variety of sources. There will often be strong defences given the speed that the pandemic has developed and its unprecedented effects. The D&O policy is there to help protect boards by ensuring they can robustly defend litigation and allow them to keep doing what is important: running their businesses.

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