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 across Asia. 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.

In this publication we discuss the risks directors (and companies) are now facing and relevant provisions in their D&O polices.

Mismanagement and Insolvency

As the economic impact of COVID-19 manifests itself around the world there is a heightened risk of claims against directors and officers. Those claims are likely to include allegations of:

- Failure to adequately manage the risks of the company by putting in place preparations to lessen the impact of such an event, such as insurance, investment in I.T solutions or other disaster contingencies.

  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.

- Failure to competently steer the company through the crisis with the least possible damage.

  Directors 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. One would hope that a court would forgive directors if they can demonstrate they listened to 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.

Such claims could be brought by entities themselves, via the derivative action process available in certain jurisdictions (in which a single shareholder can bring a claim on behalf of the company) or by liquidators following an insolvency, and are likely to be framed as breaches of the duty to act with reasonable skill, care and diligence in the best interests of the company (duties which exist in one form or another across most jurisdictions).

Directors also have a heightened risk of claims arising from insolvency – including insolvent trading. In recognition of this, and in attempt to counter the effects of the virus on businesses, some jurisdictions (the UK and Australia for example) have temporarily suspended the prohibition against insolvent trading (amongst other steps) and similar measures have just been announced for Singapore. Directors around the region should check very carefully if their governments are taking similar measures, or otherwise relaxing the rules around insolvency in these extraordinary times.

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Disclosures

We have also seen the first securities actions directly relating to the impact of COVID-19. At the time of writing, 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 further removed.

Investors (and Plaintiff law firms) 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 blue 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.

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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. This is especially so if listed in jurisdictions such as the U.S.A or Australia, which are highly active in the securities class action space.

The D&O policy

So, whilst it's by no means inevitable that directors will be found liable if sued, in order to robustly defend any actions it will be important to access defence costs coverage and/or any available indemnification from the company . A securities class action arising from false or misleading disclosures or a derivative suit alleging breach of director's 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 instance, directors will want to be aware of the presence of a "failure to obtain insurance" exclusion (albeit these are not common outside of the U.S) or an insolvency exclusion, and their scope will need to be carefully considered.

Perhaps less obviously, D&O policies normally contain a "bodily injury" exclusion limiting the extent of coverage for claims involving bodily injury, sickness, disease, death or similar. Whilst we would hope (and expect) that an Insurer would not rely on such an exclusion for a D&O claim of the type anticipated in this paper (they are generally intended to exclude claims that ought to be covered under a general liability policy or similar) it is important to check whether they are broadly or narrowly framed, and whether they contain any relevant carve backs which clarify their scope. As always it will depend on specific facts, circumstances and wordings.

And going forward, we cannot rule out the possibility of COVID–19 exclusions, or exclusions aimed at COVID–19 exposures (failure to obtain insurance, insolvency or even force majeure exclusions).

Further, if the D&O policy contains a pollution exclusion this should also be carefully reviewed to ascertain if its scope extends to viruses/pathogens, as they can often have a surprisingly broad application.

And going forward, we cannot rule out the possibility of COVID-19 exclusions, or exclusions aimed at COVID-19 exposures (failure to obtain insurance, insolvency or even force majeure exclusions). If Insurers seek to impose such exclusions on renewals careful thought should be given to whether there are any circumstances that are notifiable to the expiring policy.

Side A cover

Some final remarks should be made concerning the D&O program structure and the importance 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 very 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 Asian companies that have US shareholders cannot assume they are immune to a US derivative lawsuit and can expect expensive jurisdictional contests before the claims even proceed. Failing that there may be an increase in Old Board v New Board claims, ie by companies against their former directors;

- As touched on above, 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. 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 the scope of their Side A coverage and any dedicated additional limits.

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. 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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