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D&O Insurance Issues Arising from the COVID-19 Crisis

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Much of the attention concerning insurance coverage for COVID-19 issues understandably has focused on business interruption coverage. The most immediate issue facing most businesses has been the loss of revenues and profits because of a sharp slowdown or suspension of business, as well as the attendant extra expense to continue or resume operations. For that reason, coverage under first-party property policies has been front and center. In the longer term, however, American companies can expect to deal with a broader range of claim scenarios resulting from the current circumstances, many of which implicate directors & officers liability, management liability, fiduciary liability, and related insurance issues. Because the relevant terms in directors and officers, management liability, and fiduciary liability insurance are generally the same, we refer in this article to these coverages as "D&O." We outline below a number of D&O insurance issues companies should be focusing on now.

We have already begun to see some lawsuits filed alleging that companies and their directors and officers and other executives and employees breached their duties to the company or violated securities laws in the context of Covid-19 exposures. Depending on a company's circumstances, lawsuits alleging breaches of duties or misleading disclosures relating to COVID-19 may allege the following claims and costs, all of which could implicate D&O insurance:

- Government investigations, particularly those arising from a company's activities in response to COVID-19 issues and its applying for government loans and grants.
- Securities law claims and lawsuits arising out of COVID-19-related disclosure obligations and management issues.
- Claims by creditors, shareholders, trustees, and other company stakeholders relating to possible insolvency or bankruptcy.
- Fiduciary claims arising from the company's decisions relating to employee benefit plans and employee stock option (ESOP) and pension plans.
- False Claims Act and qui tam claims relating to federal and state funds received from various COVID-19 government programs.
- Antitrust investigations and suits for alleged price-gouging and price-fixing through communications with competitors.

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- Cyber-related claims from shareholders or customers for alleged failure to comply with cybersecurity standards or breach notification laws in the event a security event, social engineering, or other fraud is perpetrated by hackers trying to exploit COVID-19-related vulnerabilities.

In addition, the COVID-19 pandemic presents unusual challenges for companies in the renewal of their D&O policies, as well as in the timing of notices they may be required to provide insurers. Each of these issues is discussed in greater detail below.

Government Investigations

Many D&O policies contain a coverage extension for expenses incurred to respond to government investigations, including subpoenas and requests for documents, among other things. In most D&O policies affording this coverage, the coverage is available only if an individual insured receives a formal request from the government or is the target of the investigation, regardless of whether the company also is named. This coverage typically is sublimited well below the general per-claim limits of the D&O policy.

As discussed below, both entities and individual insureds may face claims and allegations arising out of the unique circumstances of the COVID-19 crisis. Among the claims that could involve related governmental investigations are:

- False Claims Act claims in connection with a company's application for loans or other assistance under the recently enacted Coronavirus Aid, Relief, and Economic Securities (CARES) Act and other programs specifically designed to respond to the COVID-19 pandemic.

- Antitrust and unfair trade practice claims arising out of alleged violations of price-gouging laws, price-fixing laws, and unfair competition through coordination with competitors.

- Whistleblower claims relating to federal and state funds received from government programs.

- Investigations by the US Securities and Exchange Commission (SEC) and its state counterparts into inadequate disclosure of a company's financial situation and other circumstances arising out of COVID-19 stresses on a company.

- Investigations by the SEC and the US Department of Justice (DOJ) into potential violations of the Foreign Corrupt Practices Act (FCPA), as certain industries become exposed to increased bribery risks resulting from the difficult economic landscape caused by COVID-19. These risks will be amplified because travel restrictions and mandatory quarantines geared toward curbing the spread of COVID-19 will result in postponed internal investigations and reduced efforts to prevent corporate misconduct and enforce compliance standards.

- Investigations by other government entities regulating financial services companies, such as the Financial Industry Regulatory Authority (FINRA), Office of the Comptroller of the Currency (OCC), and similar agencies, investigating alleged unsafe or unsound business practices, claims of public fraud, or other breach of fiduciary duties by regulated entities and licensed individuals operating in sub-optimal conditions as a result of COVID-19.

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This is a good time for companies to analyze the availability of coverage under all of their D&O policies for costs associated with responding to government investigations, particularly if the company is availing itself of loans or grants under the CARES programs. Some companies are consulting with their brokers about increasing sublimits for government investigations. Insurance policies proposed for upcoming renewal should be carefully reviewed because insurers are now proposing to add very broad "virus" or "communicable disease exclusions" and other provisions, even on D&O and other kinds of policies, in light of COVID-19. While the markets are hardening, policyholders should be vigilant about reductions in coverage and whether insurers are taking those reductions into account in their pricing.

Securities Law Claims

D&O policies may respond to securities lawsuits arising out of COVID-19-related disclosure obligations. This is of particular concern to public companies, which typically are covered for securities claims and suits under most D&O policies' "entity" coverage. With global stock markets now in bear market territory, investors will be asking whether steps could have been taken to avoid substantial losses in value. Federal regulators such as the SEC, as well as their state counterparts, impose various disclosure obligations on public companies in annual reports, securities offerings, and other filings. The SEC already has emphasized that it will be looking closely at COVID-19 disclosures by public companies about risk factors and the effect on their financial statements. Consequently, publicly traded businesses must contend not only with recouping direct losses from diminished business operations, but also with potential enforcement actions and securities lawsuits relating to the alleged failure to disclose actual or potential COVID-19 concerns.

Directors and officers face particular exposure from derivative suits for alleged failure to manage the effects of COVID-19 issues on their companies. This exposure can arise from a wide variety of management failures to act, to disclose information or to establish board-reporting processes. Last year, applying the Delaware Chancery Court's *Caremark* duty of loyalty standard, the Delaware Supreme Court reaffirmed director liability where a board of directors fails to establish a reporting process for essential compliance and governance matters. *See Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019). Although adherence to that standard will vary from company to company, the *Marchand* court held that "directors have a duty 'to exercise oversight' and to monitor the corporation's operational viability, legal compliance, and financial performance." *Id.* at 809. This is particularly true of single-product businesses, such as the ice cream company involved in *Marchand*. *Id.*

As frequently occurs when a company's stock price drops for other reasons, plaintiffs' law firms are searching for grounds to allege missing or inadequate disclosures about impending financial losses resulting from COVID-19 issues. Similarly, those firms will bring related Employee Retirement Income Security Act (ERISA) claims against the companies on behalf of the beneficiaries of various employee retirement and benefit programs.

In addition, because of the recent market volatility and economic disruptions, COVID-19 may have a significant impact on pending mergers, acquisitions, IPOs, and other business transactions. These fluctuations can lead to both increased (where potential buyers may take advantage of decreased stock prices) and decreased (such as postponing or scuttling deals involving impacted companies) financial transactions, all of which can lead to more claim activity from shareholders, buyers and other potentially impacted parties. From an insurance perspective, this is of particular interest to private companies, which

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typically have more expansive entity coverage and definitions of "wrongful acts" than in public company policies.

Claims Arising Out of Potential Insolvency or Bankruptcy

An uncomfortably large number of companies, especially those in the hospitality, retail, travel, real estate, and real estate finance sectors, are facing immediate and dire liquidity and credit crunches. Those companies' circumstances may well lead to insolvency or bankruptcy in the not-too-distant future. In the event of insolvency or bankruptcy, there is a substantial risk that the company and its officers and directors will face claims by creditors, shareholders, the bankruptcy trustee (particularly in the case of a Chapter 7 liquidation), and other stakeholders. It is especially important that there is sufficient D&O coverage for the individual insureds, whose personal assets may be at risk if the company's D&O policy provides insufficient coverage, either in the form of too-low limits or limited coverage scope in the event of a bankruptcy or insolvency.

Most modern D&O liability insurance forms contain a broad range of protections for individual insureds in the event of a company's bankruptcy or insolvency. For example, it is common for D&O policies to contain provisions stating that so-called "Side-A" coverage (i.e., insurance affording direct coverage to an organization's directors and officers) cannot be rescinded and that the policy will remain in effect even if the company goes into bankruptcy. Other protections include: (i) the carve-out if a bankruptcy trustee or receiver from the insured-vs-insured or entity-vs-insured exclusion; (ii) a priority of payments provision; and (iii) excess Side-A/difference-in-conditions (DIC) coverage (designed to fill in any gaps in coverage to provide broader protections to individual insureds only. These and other policy terms are intended to prioritize protections for individual insureds, including but not limited to situations in which the company is unable to indemnify the directors and officers due to bankruptcy or insolvency.

Although the coverage and related protections available for companies and individual insureds do not uniquely apply to the COVID-19 crisis, for many companies the current circumstances present sudden and unprecedented reasons to examine those protections. Accordingly, even those companies that are not on the brink of a financial crisis would do well to analyze the coverage that would be available to the company and its individual insureds in the event of insolvency or bankruptcy and work with their coverage counsel and brokers to shore up any missing or sub-par protections.

Fiduciary Claims

In the COVID-19 context, large stock drops and reductions in value of pension plans or the bankruptcy or insolvency of a company could give rise to related fiduciary liability claims. Many management liability policies include both D&O liability and fiduciary liability coverages. Fiduciary liability coverage is designed to protect individuals responsible for creating, implementing, administering, or managing their company's employee benefit plans, including pension, ESOP, workers' compensation, and health insurance plans. When a company is in financial distress or insolvency, as is arising now in connection with the COVID-19 crisis, two types of fiduciary claims are common.

First, there is the corollary of shareholder class action or directive claims against directors and officers and trustees of benefit plans for mismanagement or failures to disclose that lead to an unexpected drop in the company's stock price. Many employee benefit plans include company stock as part of retirement

plans and ESOPs, among others. Accordingly, when a company's stock price drops, fiduciaries of those plans can be the target of ERISA and other claims for mismanagement and breach of fiduciary duties with respect to plan beneficiaries. Enron and United Airlines are two of the most prominent examples of company stock options being targeted in securities class actions, and those same risks in ESOPs are heightened by COVID-19 and its potential impact on stock prices.

Second, when a company files for bankruptcy, particularly a Chapter 7 liquidation, fiduciaries of company benefit plans may be exposed to claims by the bankruptcy trustee or others for failing to maintain adequate cash balances for payment of unemployment premiums, payroll taxes and other amounts that are required under the Bankruptcy Code. The rapidity with which companies in certain industries are falling into financial distress, as well as the debt burdens many of those companies have, poses a genuine risk to many plan administrators and other fiduciaries.

As with any other potential set of claims against a company and its individual insureds, it is imperative that the company and its individual insureds review their fiduciary coverage to ensure there are sufficient limits both for the defense against fiduciary claims and for indemnification of any settlement or judgment against the fiduciaries.

Antitrust Claims

Many D&O liability policies contain an "antitrust exclusion," but increasingly, particularly in private company policies, the antitrust exclusion has been limited or removed entirely. When it is present, it often is overbroad and, perhaps more importantly, applied by insurers to try to preclude coverage outside what most policyholders understand to be its intended reach. Some companies have purchased coverage specifically to apply to often specific antitrust concerns or exposures. Because antitrust regulators are targeting individual defendants in antitrust enforcement actions, it is particularly important in the current environment to be aware of the degree to which D&O coverage is available for potential antitrust claims. *See* Sarah Downey, Amanda Wait & Lorelie Masters, *Optimizing Antitrust Coverage in Private Company D&O Policies*, Marsh Newsletter (Dec. 2018).

In the COVID-19 context, there are several potential avenues toward antitrust investigations and claims. First, both regulators and the public are increasingly sensitized to apparently opportunistic pricing, and enforcement agencies are pursuing companies for alleged price-gouging. A related risk is that of price-fixing through coordination with one's competitors to provide products in short supply and, in some instances, to coordinate manufacturing and distribution. Again, these are classic anticompetitive activities that might be excluded by an antitrust exclusion.

Perhaps most troublesome, many "antitrust exclusions" in fact reach a much broader range of conduct than classic antitrust violations. The exclusions often exclude coverage for investigations and claims concerning unfair competition and unfair trade practices, which reach a wide range of conduct. In the current environment, where both enforcement agencies and consumers perceive unfair trade practices and other conduct at a time of financial distress, retailers and other companies may face more claims for violations of unfair trade practice statutes and their common-law corollaries. *See* Kevin LaCroix, *The Critical Issue of Private Company D&O Insurance Coverage for Competition Law Claims*, The D&O Diary (Apr. 10, 2019). The typical state unfair and deceptive trade practice statutes, as well as the Uniform Deceptive Trade Practices Act (UDTPA), define unfair trade practices broadly and generally. For these

reasons, a company and its individual insureds would do well to analyze not only the antitrust exclusions under its D&O coverage, but also whether the antitrust exclusion could reach conduct well beyond traditional antitrust violations.

Cyber-Related Claims

While the world's attention is on COVID-19, cyberattacks, social engineering, and electronic fraud are on the rise as hackers try to exploit increased vulnerabilities, such as distracted workers, remote working, and IT and other personnel who are stretched thin. At the same time, executives and senior management are playing an important role in ensuring that their companies' cyber and data-security standards and action plans meet legal requirements and comply with any breach-notification laws. Failure to do so could result in actions by shareholders or customers alleging failure to comply with such standards and state or federal data privacy laws. D&O policies with cyber extensions or stand-alone cyber policies with D&O or fiduciary liability coverage extensions ought to be reviewed or considered to protect against such claims.

Renewal Considerations

Even before the COVID-19 crisis, the D&O insurance markets had been tightening for several years. In particular, insurers have been increasing premiums, limiting coverage, and becoming less willing to take on as much capacity for an individual company. Now that the COVID-19 crisis has hit, it remains to be seen how insurers will respond. Unlike property and liability policies, which traditionally include a broad range of excluded risks and claims, D&O liability insurance policies have relatively few exclusions, particularly with respect to Side-A-only/DIC policies. Some exclusions are labeled as such, but many others may be found as "exceptions" to the crucial definition of "Loss." Many, but not all, of these exclusions go to the knowledge and conduct of the individual insureds themselves, not the perils or risks insured against. This is consistent with the purpose of D&O insurance, which primarily is designed to cover individual officers and directors for alleged "Wrongful Acts," so that qualified individuals will serve on corporate boards and in management and be protected against a wide range of alleged acts, errors or omissions.

Although few, if any, current D&O policies contain exclusions for claims arising out of losses due to "epidemics," "pandemics," "viruses," "communicable diseases," "pathogens," and the like, insurers may attempt to insert them into D&O policies during the current renewal cycle. In addition, insurers will attempt to broaden the interpretation of traditional "pollution" or "contaminants" exclusions and definitions to include viruses and other diseases. Policyholders should resist any such exclusions or limitations to the extent possible, as they are directly contrary to the purpose of D&O liability insurance to insure against a broad range of allegedly wrongful acts in the management of a company, particularly for individual insureds.

Notice and Other Policy Conditions

The typical D&O policy requires an insured to give notice of a "Claim" when it receives "a written demand for monetary or non-monetary relief," including "injunctive relief"; a complaint or other legal process from a claimant; a request to toll the statute of limitations; or a demand or subpoena from a government agency for testimony, documents, or other information. If a company or individual insured receives such a demand or document relating to a COVID-19 issue, then, as with any other situation, the insured should

give notice of the claim to its insurer. Most D&O policies also include a "notice of circumstances" provision, which allows an insurer to provide notice of circumstances that may lead to a claim against the insureds.

Unlike a notice of claim, which typically is permitted for a specified time after the policy expires, notice of circumstances usually must be given during the policy period. In addition to the more restrictive timing requirements, the insured usually is required to give certain additional, more specific information to the insurer, typically including the identity of potential claimants, the nature of the alleged wrongful act or omission, facts concerning the potential claim, and other details that are known to the policyholder at the time of the notice. If an insured satisfies all of these requirements and gives proper notice of circumstances, coverage is "locked in" with respect to future claims the company receives relating to the matters noted in the notice of circumstances. In addition, providing notice of circumstances now, even before a true "claim" arises, may prove beneficial by preserving more favorable coverage for claims under a company's current policy in the event that insurers begin to narrow virus-related coverage or even add specific COVID-19 exclusions to future renewals.

A difficulty in the COVID-19 context arises, however, because not only are the full effects and duration of the crisis currently unknown, but also because it is equally difficult for a company to predict how the current macroeconomic environment—let alone future events—will affect the company's finances and operations. As a practical matter, therefore, a company and its individual insureds should ascertain the expiration date of the in-force D&O policies, and evaluate at least several months in advance of expiration whether a notice of circumstances is warranted. Given the uncertainty surrounding COVID-19 and its implications, this evaluation should be done with the assistance of the company's insurance coverage counsel and insurance broker.

As demonstrated above, although companies may first turn to first-party property and business interruption policies to mitigate lost business in the wake of COVID-19, the crisis also presents a host of important insurance issues under directors & officers liability, management liability, fiduciary liability, and other liability coverages. Consideration of these important D&O liability insurance coverages can play an important role in mitigating current and future COVID-19-related losses.

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