D&O CLAIMS COVERAGE IN THE TIME OF COVID-19

Nancy R. Kornegay
Trahan Kornegay Partners, LLP

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This article looks at COVID-19-spawned litigation in which claims and allegations against directors and officers, and public companies center on their COVID-19-related actions or inactions. This article starts with a general discussion of directors and officers (D&O) insurance for those who may not be familiar with it.

The remainder of the article discusses some specific lawsuits that have very recently been filed here in the United States. Despite the novel subject matter—a new global pandemic—these lawsuits allege wrongful acts that are familiar to those who deal with securities litigation. Because this is a developing area of liability, however, we will need to wait a few more months to see how D&O insurers respond as these claims are presented for defense-cost and settlement indemnity.

Basics of D&O Insurance

D&O insurance provides protection for company officers and directors in instances where the company cannot—either because of insolvency or legal impediment (Side A coverage)—provide such coverage directly. D&O insurance also provides for reimbursement of companies when they do directly indemnify their officers and directors (Side B coverage).

Fairly typical Side A and Side B coverage language states that the Insurer "will pay to or on behalf of the Insured Persons Loss arising from Claims … for Wrongful Acts." Wrongful Acts are often defined as "any actual or alleged act, error, misstatement, misleading statement, omission or breach of duty." "Loss" often includes defense costs and any damages, settlements,

judgments … that an Insured person is legally obligated to pay as a result of any Claim. Often, Side A claims are "derivative" claims—brought by shareholders on behalf of the company against the company's officers and directors for breaches of fiduciary duty, fraud, and so forth.

Most D&O insurance policies issued to public companies also contain Side C coverage providing insurance to the company for its own legal exposure. In D&O insurance policies for public companies, this Side C protection is usually limited to the company's potential liabilities under federal and state securities laws.

Unlike fairly standardized commercial general liability (CGL) policy forms, there is considerable variation among carriers' D&O policy forms. In addition, these policy forms are often extensively negotiated and heavily endorsed.

Also, unlike CGL policies, these policies have eroding limits—defense costs, which can be substantial, reduce the available limits of insurance coverage. D&O insurance policies provide coverage for *claims* made during the policy period, regardless of when the underlying conduct may have occurred. CGL policies provide the opposite—"evergreen" coverage under the policy in place when the event(s) giving rise to the claim occurred. Some D&O policies specify "past acts" dates, which cut off coverage for claims that are based on conduct occurring prior to the past-act date.

The typical definition of "Claim" extends beyond civil litigation. Most policies' "Claim" definitions include demands for monetary or non-monetary relief that need not be in the form of a formal complaint. A demand letter, for example, typically meets the definition of a "Claim" under most D&O policies. "Claim" can also encompass other types of proceedings, including criminal proceedings, and regulatory or administrative proceedings. "Claim" is also frequently defined to include quasi-judicial proceedings, arbitrations, mediations, and other forms of alternative dispute resolution.

"Wrongful Act" is usually defined as an actual or alleged act, error or omission, misleading statement or breach of duty. Be-

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cause these are liability policies, to trigger D&O coverage, there must be an allegation that the insured engaged in some wrongful conduct that gives rise to liability to a third party.

"Loss" specifies what the policy will pay—either directly or as reimbursement. "Loss" usually includes settlements, judgments, attorneys' fees, and other defense costs—all of which erode policy limits. The policy definition of "Loss" often excludes payment of fines, penalties and other costs deemed uninsurable under applicable law. A frequently contested issue in relation to the definition of "Loss" is the insurability of amounts paid as disgorgement or restitution. Because they typically represent restoration or repayment of funds that were not the defendant-insured's in the first place, insurers often challenge whether they are uninsurable as a matter of public policy. The law on insurability of these disgorgement or restitution payments varies from state to state.

"Insured" under D&O policies includes both natural persons and the corporate entiy(ties). A person's insured status under the policy is determined by their status—is this person a duly elected or appointed officer or director of the company? Entity coverage typically includes coverage for both the first-named insured and its subsidiaries. Organizations formed or acquired after the policy's inception may be additional insureds depending on relevant policy provisions addressing subsequent formations or acquisitions.

Typical exclusions address and include any prior matters that were reported or the subject of a notice of circumstance (potential Claim) under prior policies. Because they are claims-made policies, most D&O policies preclude coverage for litigation that was pending or "noticed" prior to the instant policy's inception.

Though not often categorized as an "exclusion," D&O policies invariably contain a related-claims "condition" that considers all Claims "alleging, arising out of, based upon or attributable to the same facts, circumstances, situations, transactions or events or to a series of related facts …" to be a single Claim. Given the breadth of their related-claims definitions, these conditions often operate as an exclusion and are the source of considerable D&O coverage litigation.

Most D&O policies exclude coverage for claims that are typically covered by other types of insurance—property damage, general liability, and so forth. They often include separate exclusions for loss arising from catastrophic hazards but may contain a carve-back exception to the exclusion for any shareholder suits arising from the catastrophic event where the company is unable to indemnify the directors and officers (Side A coverage).

Conduct exclusions are common—particularly for loss relating to fraudulent or criminal misconduct, and for loss relating to "profit or advantage" (illegal profits or remuneration) to which the insured was

not legally entitled. The wording of these exclusions varies from form to form, and even subtle wording differences can significantly affect the availability of coverage. Most of these conduct exclusions require that there be a final "adjudication" that the precluded conduct was determined to have occurred before the exclusion is triggered. In addition, some conduct exclusions require that the adjudication take place in the underlying claim, but others may provide that the adjudication can occur in a separate proceeding.

Most D&O policies exclude claims brought by one insured against another insured, in order to prevent coverage for collusive claims or infighting among senior corporate officials. These insured-versus-insured exclusions typically include exceptions that preserve coverage for derivative claims, cross claims, certain employment-practices claims, and claims brought by bankruptcy trustees.

COVID-19-Related D&O Litigation

At this time, there are perhaps a dozen or so COVID-19-related lawsuits against D&Os and/or public companies alleging actions that could trigger D&O coverage for defense costs and awards. It is too soon to tell whether any of these recently filed lawsuits will evolve in a way that results in insured settlements or judgments. At present, COVID-19 D&O suits are falling into two fairly predictable categories.

The first includes litigation arising out of a fall in the company's stock price—commonly called a stock-drop suit. Stock-drop suits are sometimes brought derivatively by shareholders on behalf of the company against the officers and directors alleged to have engaged in wrongdoing at the expense of the company. They can also be brought against the company as well as its directors and officers.

The second category includes failed mergers and acquisitions that are blamed on COVID-19. A potential third category would be D&O suits alleging the company engaged an acquisition or merger that was too expensive—shareholders of the acquiring entity would demand a "bump down" in the price—or that was too cheap—shareholders of the acquired entity demand a "bump up" in the price.

We can also expect to see disclosure issues related to the pandemic triggering heightened scrutiny not just from shareholders, but also from regulators and state attorneys-general.

Side A Litigation

Following is a discussion of some of the more significant recently filed COVID-19-related lawsuits that fall within typical Side A insuring-agreement language.

Local 464A United Food and Commercial Workers Union Pension Fund v. Antonellis, et al., Case No. 2020-0376

(filed in the Court of Chancery of the State of Delaware on May 15, 2020). This class-action shareholder suit alleges directors of Xperi Corporation, which is publicly traded on the NASDAQ, failed to fulfill their fiduciary obligations to their stockholders regarding a merger to become a subsidiary of XRAY-TWOLF Holdco Corporation. In the transaction, Xperi and TiVo would combine in an all-stock merger transaction. Xperi, however, would be the accounting acquiror, and TiVo stockholders were to receive a premium for their shares based on the share price at the time of the announcement. This entity would then become the TiVo subsidiary mentioned above.

Specifically, the shareholder plaintiffs allege that after the deal was announced on December 18, 2019, the Xperi Board failed to meet and reconsider the Merger Agreement in light of the COVID-19 pandemic—whether the pandemic caused a Material Adverse Effect ("MAE") and/or Intervening Event ("IE"). A determination of a MAE would allow the Board to terminate the agreement. A determination of an IE would permit the Board to change its recommendation regarding the merger.

The suit goes on to allege that the Board failed to act in good faith in refusing to consider—"summarily dismissing"—an all-cash acquisition proposal from Metis Ventures LLC. The suit alleges conflicted Xperi management and directors did not recuse themselves from the Board's dismissal of the Metis proposal. The suit further alleges the Xperi Board intentionally made materially misleading disclosures and deliberately omitted relevant and material information from the Proxy.

Each Count of the Xperi plaintiffs' class-action complaint alleges a breach by the directors of their fiduciary duty of loyalty. This is a typical Side A Claim—Insured Persons alleged to have committed Wrongful Acts that result in a Claim for Loss from those Wrongful Acts. Here, where the Insured Directors are alleged to have breached their fiduciary duty of loyalty, the company cannot indemnify the Directors for the alleged breach. The Xperi plaintiffs seek "appropriate equitable relief," Class damages, and attorneys' fees, expenses, and costs, which can be substantial.

Keeping in mind that coverage language in D&O policies can vary from form to form, and that this type of insurance is also frequently customized to the specific insured's needs and claim history, one would expect Xperi's D&O insurer to provisionally accept tender of the claim and to negotiate defense-cost reimbursement with the defendant directors. If the matter doesn't settle, and there is a final adjudication that the Directors, in fact, breached their duty of loyalty to the shareholders, then the Claim would likely be covered. It is possible, however, that under applicable law, a final adjudication that the Directors gained profit or advantage to which they were not entitled would render the Claim uninsurable.

Beheshti v. Kim, et al., Case No. 2:20-cv-01962 (filed in the U.S.D.C., E.D. Penn. on April 20. 2020). This derivative shareholder lawsuit alleges breaches of fiduciary duty by Inovio Pharmaceuticals' directors and officers along with allegations of unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. In brief, the suit asserts that Inovio's officers and directors made false statements that they had developed a COVID-19 vaccine, which they further asserted would be ready for human trials as early as April 2020.

As one would expect on the heels of such an announcement, Inovio's share price leapt from $4.15 per share at the close of trading on February 14, 2020, to a high of $19.36 per share on March 9, 2020. That same day, an online newsletter published by Citron suggested Inovio was engaged in fraud by making "the ludicrous and dangerous claim that [it] designed a vaccine in 3 hours." In reality, it turned out, Inovio only had an early-stage prototype of a potential vaccine—a vaccine construct—that could lead to a viable vaccine. Later that same day, Inovio clarified via Twitter that it had not developed a full-fledged vaccine.

Inovio's stock began a "freefall," dropping from $14.09 per share to $5.70 per share in just a few days. This price drop represented a market-capitalization loss of approximately $643 million. One of Inovio's directors was alleged to have engaged in directly related insider trading as well.

Side C Litigation

The following cases allege both Side C and Side A wrongful acts. The focus in discussing these cases is primarily on the Side C allegations.

Douglas v. Norwegian Cruise Lines, et al., Case No. 1:20-cv-21107 (filed in the U.S.D.C., S.D. Fla. on Mar. 12, 2020). This class-action shareholder suit alleges a violation of federal securities laws arising from Norwegian Cruise Lines' ("NCL") misleading and materially false statements regarding COVID-19 in its 8-K and 10-K filings with the SEC from February 20, 2020, through February 27, 2020. NCL and its directors and officers are named defendants. Specific allegations include false statements by NCL regarding its "positive outlook" for the Company's business despite increasingly alarming news about the COVID-19 outbreak.

The plaintiffs further allege NCL employed sales tactics that provided customers with unproven and/or blatantly false statements about COVID-19 so that customers would purchase cruises. In addition, plaintiffs allege the company pressured its sales force to minimize the future threat of COVID-19 and to make false statements to potential customers in order to increase lackluster cruise reservations. These allegations were based on reporting by the *Miami New Times* on March 11, 2020.

On the day the *Miami New Times* piece was published, NCL's stock price

dropped from $20.50 per share to $15.03—a 26.7% one-day drop. The following day, the *Washington Post* published an article revealing additional allegations against NCL that company managers urged salespeople to "spread falsehoods about coronavirus," which included the statement that "coronavirus in humans is an overhyped pandemic scare." That same day, NCL's stock price dropped again. This time, the stock fell to close at $9.65—a one-day drop of $5.38 or 35.8%.

Plaintiffs allege violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 against both NCL and its Directors. In addition, Plaintiffs allege violations of Section 20(a) of the Securities Exchange Act by NCL's directors and officers.

This lawsuit is a fairly typical stock-drop suit that potentially triggers Side A D&O coverage for the NCL directors and officers named in the suit. The suit also raises allegations of company misconduct that likely trigger Side C (securities-claim) coverage for NCL itself. As discussed above, Side C coverage for public companies is usually limited to liability arising from securities claims—claims brought by or on behalf of securities holders of the Company or that arise from the sale of, or the offer to purchase or sell securities issued by the company. Here, plaintiffs assert NCL publicly made false statements about the company's future business outlook and was pressuring its employees to lie to customers and potential customers. Plaintiffs allege they paid too much for stock when it was trading at "inflated" prices as a result of NCL's false statements.

Another cruise-line D&O suit was filed against Carnival in *Service Lamp Corp. v. Carnival Corp., et al.* (filed in the U.S.D.C., S.D. Fla. On May 27, 2020). In *Carnival,* shareholders allege Carnival made false statements about the presence of COVID-19-infected passengers and downplayed the extent to which various of its cruise ships were experiencing outbreaks. As with most such suits, the allegations center on public statements—primarily, through corporate public filings. As in *Douglas v. NCL,* the *Carnival* Plaintiffs allege these fraudulent and misleading statements caused the stock to trade at artificially high prices. Plaintiffs allege they purchased stock at those higher "inflated" prices. When the news got out that Carnival's ships had significant COVID-19 infections, the stock price fell $0.53 in mid-April 2020 and another $1.97 in early May.

Brams v. Zoom Video Communications, Inc., et al., Case No. 3:20-cv-02396 (filed in the U.S.D.C., N.D. Cal. on Apr. 8, 2020). This class-action suit alleges violations of Section 10(b) of the Exchange Act and Rule 10b-5 by the company (Side C allegations) and individual defendants (Side A allegations). It also alleges a violation of Section 20(a) of the Exchange Act, which imposes vicarious liability for securities fraud on controlling persons for the conduct of controlled actors with excep-

tions for good faith and lack of inducement of the controlled actor. The Section 20(a) allegations against the individual defendants would likely also fall under Side A D&O coverage.

The facts are alleged as follows. In March 2019, Zoom began the process of going public. This initial public offering (IPO) was completed on April 18, 2019. Zoom's IPO was successful—it sold 9,911,434 shares for $36.00 per share. The Zoom shareholder plaintiffs allege that Zoom made materially false and misleading statements from the beginning of its IPO when Zoom touted its "unique technology and infrastructure" [that] enable best-in-class reliability." Its offering documents went on to state that Zoom "offers robust security capabilities, including end-to-end encryption, secure login, administrative controls and role-based access controls."

In July 2019, security researchers and public-interest groups started going public with concerns that Zoom was putting its users' privacy and security at risk. Zoom shares fell $1.32 per share on the heels of these publicly voiced concerns. Through the rest of 2019 and into early 2020, Zoom downplayed these risks and related legal proceedings before the Federal Trade Commission.

Throughout the first quarter of 2020 and into April 2020, governmental stay-at-home and shelter-in-place orders resulted in a surge in Zoom usage. Its share price followed suit. Zoom entered 2020 with a share price of approximately $68.00 per share. By March 23, 2020, its shares had climbed to $165.00 per share. With wider usage came more intense scrutiny of Zoom and its inaccurate statements about privacy and encryption protocols. National news media started featuring stories of, among other security and data-breach concerns, Zoom meetings being Zoom-bombed and users' data being hacked and shared without their permission and in direct conflict with company statements about protecting user data. Various companies—including SpaceX and NASA—banned employees from using the Zoom meeting app. Consumer class actions were filed against Zoom.

As a result, between March 27, 2020. and April 2, 2020, Zoom's share price fell $29.77 per share. More bad news and litigation followed. Zoom was forced to make public disclosures regarding its security flaws. By April 6, 2020, Zoom shares had dropped to $122.94 per share from a March 23, 2020. high of $165.00 per share. Adding to the bad optics, several Zoom executives sold substantial numbers of their company shares in mid-March. As in *NCL* and *Carnival,* Zoom's shareholders allege they paid inflated prices for Zoom stock because of the tardy disclosures about security flaws.

The Arbitrage Fund et al., v. Forescout Technologies, Inc. et al., Case No. 3:20-cv-03819 (filed in the U.S.D.C., N.D. Cal. on June 10, 2020). This suit involves the failed acquisition of Forescout by Ad-

vent Technologies and alleges failure to disclose by Forescout, its CFO, and the dual-hatted CEO/Board Member DeCesare when that deal began to unravel. Forescout, a computer-and-network-security company, supposedly withheld disappointing fourth-quarter 2019 earnings news. In addition, Forescout was alleged to have inflated reported earnings through a one-off transaction with one of its largest resale customers. The gist of the shareholders' complaint is that Forescout knew as early as March 2020 that Advent had concerns regarding Forescout's finances, and that through April 2020, Forescout refused to provide updated financial information and projections to Advent. Plaintiffs alleged Forescout's CFO and CEO/Director "stood to receive over $42 million from the transaction with Advent."

During the negotiations, COVID-19 hit the Asia Pacific Japan ("APJ") region hard, which is where Forescout was experiencing "significant financial collapse." Plaintiffs allege Forescout withheld this information, and that Forescout knew there was a greater material risk the Advent transaction would not close. Plaintiffs allege that by March 24, 2020, when Forescout issued its Definitive Proxy Statement, the company knew COVID-19 was severely impacting its business, and that Advent had started to express concerns about Forescout's financial performance. The deal fell apart on May 15, 2020 when Advent sent Forescout a letter stating that it would not be proceeding with the transaction on May 18, 2020.

Forescout's stock quickly fell from $29.52 per share to $22.57 per share. The stock declined further the next day to $19.85 per share. It was later revealed in subsequent litigation Forescout brought against Advent over the failed transaction, that Advent's letter terminating the transaction cited both a material breach of various covenants by Forescout and that a Company Material Adverse Effect—significant decline in Forescout's value—had occurred.

The shareholder claim against Forescout includes allegations that Forescout violated Exchange Act Section 10b, Rule 10b-5, and Exchange Act Section 20(a) Thus, like the Zoom litigation discussed above, plaintiffs' claims against the company and the individual defendants raise both Side A and Side C allegations.

Gelt Trading, Ltd. v. Co-Diagnostics Inc. et al., Case No. 2:20-cv-00368 (filed in the U.S.D.C. of Utah on June 15, 2020) arises from an alleged pump-and-dump scheme—that the company and the company's officers and directors made false and misleading statements that Co-Diagnostics' COVID-19 test was 100% accurate. The stock price rose quickly after these public statements, The directors and officers exercised low-priced options at the height of the stock's trading price, and then sold ("dumped") their stock into the market before revelations of the falsity of these statements caused the stock to drop from an all-time high of $29.72, and a market capitalization of over $800 million,

to a low in the range of $15 to $16. These allegations raise potentially covered Side A and Side C claims.

Hartel v. The GEO Group, Inc., Case No. 9:20-cv-81063 (filed in the U.S.D.C. of S.D. Fla on July 7, 2020) is another federal securities class-action (stock-drop) suit asserting both Side A and Side C claims. In brief, the plaintiffs allege that between February 27, 2020 and June 16, 2020, GEO Group, which designs, finances, and operates private prisons and halfway houses, made false and misleading statements about its COVID-19 response procedures. The shareholder-plaintiffs point to several specific instances including GEO Group's 2019 10-K Annual report and an earnings call on April 30, 2020, in which GEO Group failed to disclose "ineffective COVID-19 response procedures," and that the company was "vulnerable to significant financial and/or reputational harm." On the heels of a news story about a COVID-19 outbreak at one of its facilities, GEO Group's stock dropped from $13.20 to $12.17 on June 17, 2020.

Another D&O claim based directly on company representations regarding treatment or testing of COVID-19 patients is *Wasa Medical Holdings v. Sorrento Therapeutics, Inc. et al.,* Case No. 3:20-cv-00966 (filed in the U.S.D.C., N.D. Ca. on May 26, 2020). On May 8, 2020, Sorrento issued a press release regarding a partnership with Mount Sinai Hospital to develop antibody therapies to target and block COVID-19 infections. One week later, Sorrento announced it had discovered an antibody that "demonstrated 100% inhibition of [COVID-19] virus infection." News of the inaccuracies of these statements resulted in a significant drop in the trading price—from a high of $10 per share to a low of $5.07—in seven days. The shareholder-plaintiffs allege Sorrento's statements about the antibody were false, misleading, and made for the purpose of a pump-and-dump scheme.

Potential Coverage Issues Going Forward

Given that the negative economic impact of COVID-19 is expected to last some time, additional COVID-19-related Side A and Side C suits are likely. Additional stock-drop suits could soon be filed on the heels of disappointing second- and third-quarter 2020 earnings news from public companies. Overly optimistic statements from science-health-technology companies regarding treatment or diagnostics may lead to more litigation. Side A suits alleging D&O fraud and self-dealing—sales of personally held stock on the eve of negative financials being made public—may increase.

Several potential coverage traps await D&O insureds. One depends on the timing of the company's D&O insurance renewal. Public companies can expect a push by insurers for COVID-19-specific exclusions to be included in new policies. Another risk is a possible broadening of the

related-claims language in policies so that more claims and notices of potential claims fall within the scope of these broadened related-claims provisions. This would push any coverage for COVID-19-related claims into one policy period and its attendant policy limits.

Public companies will almost certainly face increased pressure to disclose information about their COVID-19-related risks under applicable disclosure and reporting laws. Heightened corporate disclosure requirements bring with them a greater risk of securities-fraud litigation. Along with these disclosure requirements, if a company's D&O insurer finds that the policy application or renewal forms lacked sufficient candor, the company may find itself without coverage for COVID-19 D&O litigation should the insurer exercise its right to rescind coverage.

Coverage issues arising from COVID-19-securities litigation will emerge and evolve over the next few months. As they do, subsequent updates will follow.