WHAT A DIFFERENCE A YEAR MAKES? AN UPDATE ON COVID-19-RELATED D&O ISSUES

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April 2021

A year out from the World Health Organization's declaration that COVID-19 was a pandemic, some twenty-eight COVID-19-related securities suits have been filed. In a July 2020 Deep Dives article, we discussed the basics of D&O coverage, several of the COVID-19-related D&O suits on file at that time, and potential coverage issues related to those lawsuits. Here, we discuss a few of the most recently filed COVID-19 suits, current settlement trends for securities litigation, generally, and some noteworthy recent D&O coverage decisions that are likely to impact future coverage disputes—whether COVID-19-related or not.

Recent COVID-19 D&O Litigation

As was true of much of the earlier group of COVID-19 securities claims, the most recently filed cases include allegations against individual directors and officers as well as allegations against the companies themselves. Following are three of the more notable cases.

Guo v. Tyson Foods, Inc. et al., Case No. 1:21-cv-00552 (filed in the U.S.D.C., E.D.N.Y. on Feb. 2, 2021). This class-action lawsuit alleges violations of the Securities Exchange Act of 1934 (the "Exchange Act") by Tyson Foods and three of its officers (thus triggering Side A and Side C claims under Tyson's D&O policy). Tyson Foods is incorporated in Delaware and has a head office in Arkansas.

The gravamen of the plaintiffs' claims center on Tyson Food's 10-Q filings for 2020. Plaintiffs allege materially false and misleading statements by Tyson Foods because it failed to acknowledge the world-

wide spread of COVID-19; that it did not have sufficient safety protocols in place—contrary to its assertions otherwise; that the disease spread through its facilities; and that these failures resulted in financial harm and lowered production.

In their complaint, Plaintiffs note that in December 2020, New York Comptroller Stringer called on the SEC to open an investigation into Tyler Foods. Once Comptroller Stringer's allegations were made public, Tyson Foods' share price dropped 2.5% on "unusually heavy trading volume." Plaintiffs claim they purchased stock at the higher trading price, which they allege was "artificially and falsely inflated" by Tyson Foods' false and misleading statements.

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Published by IRMI:
International Risk Management Institute, Inc.
Jack P. Gibson, Publisher
Bonnie Rogers, IRMI Editor
12222 Merit Drive, Suite 1600
Dallas, TX 75251 • (972) 960-7693
www.IRMI.com

Leung v. Bluebird Bio, Inc., et al. (filed in the U.S.D.C, E.D.N.Y. on Feb. 12, 2021).

Like the *Guo* matter, this case brings claims against individual directors and officers and bluebird bio [sic] (triggering Side A and Side C D&O coverage). Bluebird bio is a Delaware-incorporated, biotechnology company that is engaged in the research, development, and commercialization of gene therapies for severe genetic diseases and cancer. Plaintiffs' allegations center around a potential treatment for sickle cell disease ("SCD") called LentiGlobin. Its principal executive offices are in Massachusetts.

Plaintiffs allege that bluebird bio's May 2020, mid-COVID-19 pandemic, announcement that it expected to submit a U.S. Biologics Licensing Application ("BLA") to the FDA for LentiGlobin in the second half of 2021 was false and misleading for the following reasons: (1) data submitted in its BLA was insufficient to show necessary drug-product compatibility; (2) Defendants minimized the foreseeable impact COVID-19 disruptions would have on their BLA submission schedule; (3) that a delay in the BLA submission was foreseeable; and (4) as a result, bluebird bio's "public statements were materially false and misleading at all relevant times."

On November 4, 2020, bluebird bio announced it would not be applying for FDA approval in mid-2021 as previously stated. The company cited the FDA's request for additional data to "demonstrate drug product

compatibility," and "COVID-19 related shifts and contract manufacturing organization COVID-19 impacts" as the reasons for a delay until late 2022 for its submission. On November 5, 2020, bluebird bio's stock price fell $9.72 per share, which was a 16.6% drop.

As the above-discussed allegations demonstrate, this case is a "once removed" COVID-19-related claim. The thrust of Plaintiffs' COVID-19-related allegations is that bluebird bio had assured the market—via investor newsletters and conference calls with investors and analysts—that it "had accounted for COVID-19's impact on the Company's ongoing operations, including its BLA submission for LentiGlobin. See Complaint at paras. 22-26.

Lewis v. CytoDin, Inc., et al., Case No. 3:21-cv-05190 (filed in U.S.D.C., W.D. WA on March 17, 2021).

CytoDyn, a biotechnology company that developed a drug named "Leronlimab" as a therapy for HIV patients, and its officers Nader Pourhassan (CEO), and Michael Mulholland (CFO) face a purported class-action suit by shareholders (triggering Side A and Side C coverage), who purchased CytoDyn stock between March 27, 2020 and March 9, 2021. The complaint alleges that after COVID-19 was declared a pandemic, CytoDyn "made an about-face" and began "to aggressively tout Leronlimab as a treatment for COVID-19." Plaintiffs allege that after this "pivot to hyping Leronlimab as a treatment for COVID-19," CytoDyn's stock price rose "exponentially," from below $1.00 per share in 2019 to more than $10 per share at its peak on June 30, 2020. The complaint further alleges that CytoDyn, through press releases, interviews, and aggressive use of third-party investor relations and stock newsletter services, touted "Leronlimab as a potential treatment for COVID-19" in an effort to inflate its stock price.

The complaint further alleges that while CytoDyn's share price was inflated by COVID-19 "cure hype," long-term shareholders, including the CEO and CFO, "dumped millions of shares." The complaint further alleges that "following the Individual Defendants' cash-out of CytoDyn shares at artificially inflated prices," the price of CytoDyn shares "dropped precipitously" causing injury to the plaintiff class, once the market "learned that CytoDyn's development and marketing of Leronlimab as a treatment for COVID-19 was not commercially viable." The CytoDyn complaint, unlike almost all of the other COVID-19-related complaints, proposes a nearly year-long period running from March 27, 2020 to March 9, 2021.

Although no significant "wave" of COVID-19 securities actions has materialized—yet, and may never—the current overall resilience of the stock market may have something to do with the relative paucity of such claims. After all, without a significant drop in share price, shareholders have a difficult time articulating a claim for monetary damages. Events in the second half of 2021 and first half of 2022 will likely

reveal whether or not COVID-19 securities claims constitute a significant category of risk. As to the eventual outcome of the currently pending securities claims, we will have to wait and see. Settlements, if any, may be a few years away.

Current Trends in Securities-Claims Settlements and Securities Coverage Cases

The vast majority of securities cases settle. It has been reported that since 1996, more than 5,200 securities class-action lawsuits have been filed, but no more than 25 of them have gone to trial. See Stanford Law School Securities Clearinghouse at *securities.stanford.edu.* According to Cornerstone Research, securities claims take, on average, a little over three years to reach settlement from date of filing. *See* Cornerstone Research, Securities Class Action Settlements—2020 Review and Analysis. The earliest reported settlements occurred prior to a court ruling on the defendant's motion to dismiss.

Of the settled securities claims from 2011 to 2020 in which it is discernible that insurers contributed to settlement funds, more than 90% of the total settlement fund for claims alleging violations of the Securities Act of 1933 ("'33 Act Claims"), were provided by D&O liability insurance. It has also been reported that seventy-seven securities-class-action settlements were approved in 2020, and that the total settlement dollar amount was $4.2 billion. The median settlement amount in 2020, however, was reportedly $10.1 million. Driving up the total settlement amount last year were several large settlements equal to or greater than $100 million. These settlements ranged from $149 million to $1.2 billion. *Id.*

Given that the majority of these cases settle, and that many of them allege conduct by directors and officers that the company is prohibited from indemnifying (Side A claims), insurer-funded or -contributing settlements are essential. D&O policy forms are myriad, and seemingly subtle differences in policy language can have significant impacts on coverage. We turn now to a discussion of the key language in D&O policies impacting insurer-funded settlements—conduct exclusions and "final adjudications."

Final-Adjudication Variations in Conduct Exclusions

Several recent court decisions interpreting some of the various final-adjudication requirements in conduct exclusions demonstrate the impact seemingly subtle verbiage differences can affect. A typical conduct exclusion states the insurer shall not pay a loss:

> based upon or arising out of:
>
> a. the gaining of any profit, remuneration or advantage to which the Insured was not legally entitled as determined by a final adjudication in the underlying action or in a separate action or proceeding; or

b. the committing of any deliberate fraudulent or deliberate criminal act by the Insured as determined by a final adjudication in the underlying action or in a separate action or proceeding.

A similar version states:

> The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against any Insured … arising out of, based upon or attributable to the … committing of any deliberate criminal or deliberate fraudulent act, or any willful violation of any statute, rule or law, if *any final adjudication* establishes that such deliberate criminal or deliberate fraudulent act, or willful violation of any statute, rule or law was committed.

(emphasis added).

The first version was at issue in *Twin City Fire Insurance Co. v. SLRA, Inc. et al.* (Case No. 19-cv-06131-JSC in U.S.D.C., N.D. Ca.). Pursuant to a declaratory-judgment action, Twin City sought reimbursement of $2.5 million in defense costs from SLRA. Twin City argued that an SEC order SLRA and the SEC entered into, which stated that an agreement regarding the alleged unlawful actions was "[s]olely for the purpose of these proceedings and any other proceeding brought by or on behalf of" the SEC, fell within the policy's final-adjudication exclusion.

The court disagreed and ruled that under California law, which the parties agreed controlled interpretation of the at-issue insurance policy, the SEC order in dispute was not a final adjudication under the illegal profit/deliberate act exclusions in the Twin City excess insurance policy. (Order signed June 5, 2020, Slip Copy, 2020 WL 3035793). That was not the end of the parties' coverage dispute—Twin City also argued that its declaratory-judgment action was, per the policy wording, "a separate action or proceeding" in which the insured's alleged conduct could be finally adjudicated. The court agreed. *Id.* Thus, Twin City was allowed to proceed to trial to determine coverage for defense costs on the merits of an underlying action that had been resolved. As of this writing, the trial is scheduled to begin on January 4, 2022.

In *Rochester Drug Co-operative, Inc. v. Hiscox Insurance Co., Inc.,* the wording in the second exclusion quoted above, led to a very different result. 466 F. Supp. 3d 337. There, the insured entered into a deferred prosecution agreement ("DPA") and stipulation with the State of New York over Rochester's alleged involvement in the unlawful distribution of opioids ("the NY Opioid Lawsuits"). Hiscox denied it had a duty to reimburse Rochester's defense costs. When Rochester sued Hiscox for defense-cost reimbursement, Hiscox argued that the DPA and Stipulation, and the admissions of fact contained therein, constituted a final adjudication. The court disagreed, stating that "neither the purpose nor the execu-

tion of a deferred prosecution agreement comports with the plain meaning of 'final adjudication.'" The story does not end there.

Hiscox filed a motion for reconsideration and argued that the court's prior ruling on the DPA was, itself, a final adjudication of the underlying claims. Unsurprisingly, the court found this "circular argument" unpersuasive and called it "patently frivolous." 2021 WL 671603 (Feb. 2, 2021 Slip Op.). Rochester argued that "any final adjudication" really meant that the final adjudication must occur in the underlying proceeding and not the parallel coverage lawsuit. *Id.* at *4. The court agreed with the insured.

A recent decision out of California held that an arbitration award without an order from a court confirming the arbitration award is not necessarily "final" for purposes of a final-adjudication requirement. *Scottsdale Ins. Co. v. Fineman,* Case No. 4:20-cv-00368 (U.S.D.C. N.D. Ca., Order of Feb. 5, 2021). The conduct exclusion in *Fineman* applied only after "there is a final adjudication against such Insured as to such conduct (including the exhaustion of all appeals, petitions and rehearings) in such Claim." The court focused on the difference between the policy's "final judgment" requirement as opposed to requiring "merely a 'final adjudication of disputed facts.'" Because the arbitration award was never subsequently confirmed by a court, "there was no final judgment."

Hardening Markets and Potential Narrowing of Conduct-Exclusion Wording

Since early 2019, the D&O market has been experiencing what the insurance world refers to as "hardening"—higher premiums, higher retentions, lower limits, and less capacity in the market. A history of underpricing, the increase in claim frequency and size of settlements, and growing underwriting losses have all been cited as reasons for a more expensive D&O placement experience.

Although concerns about COVID-19-related claims have had some effect on the D&O insurance market, there are several reasons why the D&O market is constricting. Securities-litigation costs are on the rise; public companies have been the targets of some 400 securities suits in each of the last three years; a growing number of these suits are derivative actions, and they are becoming more expensive. Side-A coverage for these derivative actions, which has historically been readily available and relatively affordable, may increase in cost due to the increased frequency of derivative actions.

Going forward, D&O insurance purchasers can expect further rate increases, closer scrutiny from carriers during underwriting, and, again, lower liability limits. As recent conduct-exclusion litigation demonstrates, conduct-exclusion policy language, which varies greatly from form to form, may broaden in concert with the

additional coverage risk posed by COVID-19-related securities litigation, and in response to unfavorable market conditions. Because there is no standard D&O insurance policy, each D&O insurance carrier has forms that can differ significantly from its competitors,' and quite a few policies are the subject of extensive negotiations. As D&O insurers continue to review recent court rulings on conduct-exclusion verbiage, they may decline to offer endorsements with insured-friendly, "final adjudication" language and instead offer endorsements that expressly allow for a separate adjudication of the insured's conduct as was included in the *Twin City* D&O policy discussed above.