White and Williams LLP

Underwriting D&O Risks for Coronavirus (COVID-19)-Related Exposures

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Among the many dramatic changes to Americans' personal and professional lives during the past few weeks has been the noticeable absence of established guidelines and information on how to conduct business in this markedly-changed environment.

We've been reading with great interest blog posts and articles published by several of the law firms that regularly represent large companies in corporate America, and which provide counsel regarding new areas of focus and change in order for directors and officers (D&O) of public companies to effectively conduct their duties, as well as to minimize their potential liability exposure to Securities Exchange Commission (SEC) scrutiny and private civil litigation relating to the COVID-19 pandemic. This type of advice can be helpful to D&O underwriters trying to assess the readiness of prospective D&O risks for dealing with the expected litigation fallout from the COVID-19 pandemic.

At this early point in time, other than a few unique sets of facts, the kinds of shareholder D&O cases we've seen so far relating to COVID-19 (e.g., a pharmaceutical company falsely claiming to have already developed a vaccine for COVID-19 or the cruise line that was employing misleading sales practices related to the outbreak)[1] aren't likely to be widely replicated. Moreover, as a practical matter, with respect to historical practices and disclosures, it would seem difficult to plausibly allege that a particular director or officer had prior knowledge about, or reasonable anticipation of, the COVID-19 pandemic, given how quickly this has developed since January 2020.

Under such generic facts, it's difficult to imagine, for example, that a court would conclude that a board breached its *Caremark* duties[2] by not already having a supply chain backup plan or other specific, operational plan in place to deal with a future pandemic. That said, the Delaware Supreme Court's decision in *Marchand v. Barnhill*[3] last year was a wake-up call to boards that might otherwise operate in a business-as-usual environment when they should know otherwise. In that case, the company's ice cream production operations had been significantly impacted by a listeria outbreak. The court faulted the board for failing to implement "any system to monitor [the ice cream company's] food safety performance or compliance." Our corporate partners published a post on that decision.

Given the uncertainty in the financial markets about the future course and long-term economic impact of the COVD-19 pandemic, the current equity market volatility does not appear to be distinguishing among the companies or industries where the market is driving down stock prices across the board. Of course, that is likely to change in the coming weeks as the market tries to sort out post-COVID-19 winners and losers. (We already expect that airlines, travel and hospitality companies will be on the losers list, and that supply-side companies like Amazon, Target, Walmart and other providers of household goods are likely to be winners.)

That self-evident assessment tells us almost nothing about what corporate management should be expected to do now that the COVID-19 pandemic is here, including how management should be addressing this new reality going forward. Of course, how management intends to address this new operating environment is of keen interest to the D&O underwriters being asked to insure those risks.

With all of that in mind, here are some questions a D&O underwriter might now ask before underwriting a public company D&O risk in the COVID-19 era:

Board Issues

- Is your board changing the frequency and manner of its full board and committee meetings? Has it formed any new committees to promote rapid-response decision-making as external developments warrant?
- How does your board define "informed decision-making" in this new environment, and what internal or external resources are being brought in to help keep the board informed?
- What protocols does the company (including the board) have in place with respect to continuity planning? What plans has the company made for the possibility that senior members of management – including the CEO, COO and CFO – become ill and are unable to function effectively? What arrangements, if any, are being taken to insulate more medically-vulnerable members of the board or senior management (including based on age or underlying medical condition) from the risk of viral infection? What disclosure obligations does the company believe it has with respect to these continuity planning issues?
- How do the board members communicate with each other, especially when individuals are working remotely? Private email? Text? Is the company's general counsel advising board members about the discoverability of privately-sourced communications relating to board business?

Company Risk Management

- What changes in travel policies or intra-company personnel engagement has the company made? Does the company have concern that any of these changes adversely impact the company's continuing obligations under employment laws and, if so, what steps has the company taken to reconcile these changes with its legal employment obligations?
- How does the company plan to balance its HIPAA obligations to its employees with notice obligations to other employees regarding positive COVID-19 employee tests, or the onsite presence of an individual who has been exposed to other COVID-19-positive individuals?
- Is the company changing any aspect of its executive compensation, including the timing or amount of equity-based grants, in light of ongoing market uncertainty about the continuing accuracy of historical earnings guidance? A related question could go to possible changes to permissible trading of company stock by insiders.
- Is the company considering changes to its disclosures regarding internal controls and external audit functions given the potential for reduced access to the company's premises while COVID-19 pandemic movement restrictions are in place?

Financing/Liquidity

- Is the company considering material developments with respect to its interest in adding debt, either in the form of loans or debt securities, to address prospective liquidity issues?
- Does the company have a plan to reduce operations in the event of a continuing economic decline negatively impacting the company, including a wind-down plan, which has been vetted by wind-down experts and legal advisors?
- Is the company considering any changes to its existing programs relating to share dividends, stock buybacks or cash management?

Disclosure Considerations

- Are there prior disclosures, including those relating to supply chain logistics, or customer demand, that the company will be changing in light of current market conditions? Are there suppliers or customers that represent a viable bankruptcy risk to your business?
- Is the company anticipating its practical or financial inability (or that of a counterparty) to comply with contractual obligations in light of COVID-19 business restrictions or economic dislocation? Does the company expect "force majeure" principles to excuse such performance? How does the company plan to disclose those issues to investors and to the SEC?

Cybersecurity Considerations

- What are your plans for addressing the potential for increased cybercrime due to a remote access workforce (if applicable), including data breaches through employees' remote access devices?
- Is the company undertaking any efforts to reconsider its system's capacity and integrity to be able to operate under a new working model?

On a going-forward basis, *Caremark* and disclosure claims are more likely to be evaluated on the basis of what companies and boards have learned from what has happened to date, and how well they address or disclose all of the facts and risks attendant to their reactions to what has happened, as well as future plans. There may also be risk where companies inaccurately blame the COVID-19 virus for adverse developments at their company where the real problem was mismanagement or just plain bad executive conduct. And of course, there's D&O risk if and to the extent the current market volatility leads to bankruptcy filings.

With respect to securities fraud class actions, a significant disconnect between the market's understanding of a public company's business plans and how that business is actually being managed is often the critical factor in anticipating stock price volatility and the potential for securities class actions.

D&O underwriters cannot – and do not – expect that the public company risks they underwrite will never experience a D&O claim, and especially a shareholder class action or derivative claim. However, underwriters and their policyholder counterparts would benefit from a candid dialogue and a shared understanding about the insurable risk profile of public companies in the midst of the COVD-19 pandemic, and even before there's any consensus about the future path of the financial and economic dislocation the pandemic is already causing.

Buckle up, folks.

If you have questions or would like further information, please contact John McCarrick (mccarrickj@whiteandwillams.com; 212.714.3072) or another member of the Financial Lines Group.

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates here.

[1] Hat tip to Kevin LaCroix and The D&O Diary (www.dandodiary.com) for flagging these two recently-filed lawsuits.

[2] So-called "*Caremark*" claims are claims that directors breached the fiduciary duty of loyalty by not making "a good faith effort to oversee the company's operations." *See In re Caremark Intern. Inc. Derivative Litigation*, 698 A.2d 959 (Del.Ch. 1996).

[3] 212 A.3d 805 (Del. 2019); *see also, e.g., In re Clovis Oncology, Inc. Derivative Litig.*, C.A. No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019).(holding that the board of a pharmaceutical company "comprised of experts" and that "operates in a highly-regulated industry" should have understood the negative implications of "red flags" raised with respect to performance of the company's drug in clinical trials).