

CORONAVIRUS – A BUMPY ROAD AHEAD FOR D&O

THE NEED FOR EXPERT DRIVERS

Globally, insurers are waiting to see how COVID-19 related exposures will impact their respective D&O books. RPC has accessed a number of pre-eminent insurance practices in the major claims centres to swap notes on the possible D&O exposures in their respective jurisdictions and how they envisage insurers might act in response.

Taking this global perspective, the various law firms anticipate a spike in notifications to D&O policies, but the exposures will take different forms and happen at different speeds.

SECURITIES CLASS ACTION CLAIMS

There are already a number of reported COVID-19 related class action claims, inevitably filed in the **United States**. One relates to statements made by a cruise line operator relating to its business preparedness to mitigate the risks of COVID-19 and its financial resilience to cope with the pandemic. Another relates to a pharmaceutical company's allegedly misleading

statements regarding the testing of a potential vaccine.

Prior to Covid-19, pharma was a challenging sector for D&O insurers. John DeLascio partner at **Hinshaw & Culbertson LLP** expects this will continue but also identifies other sectors that will be in the spotlight: "we expect there will be many other such class-action complaints filed by shareholders in the wake of COVID-19, with the targets being similarly-situated companies who have been strongly impacted by the COVID-19 epidemic – both positively and negatively, ie, travel and leisure industries, as well as pharma and medical companies." Underwriters will be scrutinising applications from



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these sectors particularly carefully and may wish to make enhanced enquiries about their preparedness, market statements and financial strength.

Colin Biggers and Paisley partner Jonathan Newby identifies the same risk arising in **Australia** – “Misleading statements in accounts and misleading statements to the market are the major source of Side C claims in Australian class action litigation. Depending on the nature of the statement, directors responsible for misstatements can be joined to such actions. This will continue to be an area of great underwriting risk, particularly with a recent announcement of additional capital becoming available to a key litigation funder in Australia. The immediacy of this risk has resulted in the Business Council of Australia approaching the Treasurer to use emergency powers to freeze securities class action and provide protection to companies and directors arising from Covid-19 related disclosures.

That blanket intervention would however be unprecedented and has already garnered strong opposition from investor groups. In the absence of intervention the litigation funders are poised to test the new parameters.”

This view was also echoed by colleagues in the **Netherlands** – another jurisdiction which has emerged as a European jurisdiction of choice for many class action claimants. Bart-Adriaan de Ruijter at **Kennedy Van der Laan** in Amsterdam explains that – “Dutch law contains specific clauses that create quasi strict liability for managing directors for misleading financial information (annual accounts, annual report and interim report). Moreover we have a relatively liberal and competitive class action climate, especially now that the Collective Damages Act (WAMCA) has entered into force as from 1 January 2020. In the last years we have seen several international class actions (in relation to misleading financial information) that started in the Netherlands, such as Steinhoff, Petrobas, Fortis and Imtech. On the basis of the WAMCA, injured parties can not only get a declaratory judgment, but also claim damages via collective action.

In other jurisdictions the threat of COVID-19 related shareholder claims will be present but perhaps less acute. In the **United Kingdom** shareholder claims are made under sections 90 and 90A of the Financial Services and Markets Act 2000 (FSMA). The former relates to public offerings of shares – we anticipate a prospectus issued now would be

bullet proofed for Coronavirus exposures. S90A provides a route for shareholder claims arising from a broader class of statements notified via a Regulatory Information Service, such as interim reports, but there are important limitations which provide a check to such claims. Simon Goldring from **RPC** in London explains further – “there are two important hurdles which claimants have to overcome to make good a s90A claim, namely first, they have to establish they relied on the statement in making their investment decision and secondly that one of the main board directors was dishonest in allowing the company to make that statement.” That said, he says: “we have sophisticated litigation funders and Claimant law firms who scout for potential claims, actively scrutinising for corrective statements, which if made could be the basis for such claims”.

CONTINGENCY PLANNING AND INSURANCE

At present the COVID-19 timeline spans only from December 2019 – for many of us it feels far longer of course. Companies like governments are deflecting criticism for not acting earlier when, it is argued by some, there was a reasonable basis to foresee what might happen.

Some companies, as with some governments, are coping better than others. From a D&O perspective it might be differences between otherwise comparable businesses that trigger investigations and criticism into/against company directors by employees, shareholders and creditors.

All of the contributing law firms expect to see litigation against directors arising from companies failing to put in place, fund and then follow contingency plans. Risk management processes and procedures will be scrutinised. As will the adequacy of company insurance programmes – and a common theme is the lack of cyber cover as a potential source of D&O claims against directors. An unwelcome product of the COVID-19 crisis so far has been the escalation in cyber crimes perpetrated on companies by fraudsters.

Simon Ndiaye from **HMN & Partners** in **France** provides these observations: “continuity plans are not necessarily existent or correctly applied in all companies, especially in very small businesses. Directors could at a later stage

face claims (from employees or minority shareholders) for loss of value of the shares or loss of profits resulting directly from a failure to comply with a business continuity plan, or failure to have implemented one... with respect to failures to obtain adequate insurance to cover for COVID-19 losses, such a source of D&O claims would be mainly theoretical in France as directors are rarely sued for failure to take out insurance, except in the case of mandatory insurance (eg construction insurance) and the liability will lie on the company. Again, for the liability to be attributed to the director personally, one should prove that such wrongful act can be separated from the director’s management functions. In this case, brokers and/or risk managers would be at risk but the impact of those claims should not be significant for the market. However, there might be a risk for directors of companies that have not taken out appropriate cyber insurance to respond to cyber attacks which are significantly growing in this period, taking into account the massive numbers of employees working remotely and the multiplication of the risk of vulnerabilities. This failure to obtain cyber insurance might be regarded as a management failure of the director.”

In the **US** representing the world’s largest market for cyber insurance **Hinshaw and Culbertson** agree. Kevin Joseph Burke explains – “The failure to obtain cyber coverage may become the most critical failure of management by directors when it comes to procurement of insurance before COVID-19 hit. Under prevailing U.S. law, corporate boards have a duty to oversee compliance and monitor material corporate risks. This requires the establishment of appropriate reporting systems and procedures that enable the board to appropriately discharge its oversight responsibilities. In the wake of the COVID-19 pandemic, the materiality of corporate and privacy risks has significantly increased. Organizations have had to scramble to remain operational in the face of government shutdown orders and other COVID-19 related disruptions. The massive shift to work-from-home for many employees has exponentially increased their reliance on a wide variety of technologies to communicate and work remotely, which vastly expands the attack surface for cyber criminals. In addition, remote employees may utilize personal devices and be more inclined to adopt workarounds and bypass mandated business processes in favour of easier, but less secure, tools. Cyber criminals are further exploiting the situation by tailoring phishing scams specifically aimed at remote workers, and by posing as COVID-19 resource centres and charities.

It is unlikely that many organizations had tested policies and procedures in place to minimize the cyber and privacy risks associated with this sudden and new normal, meaning that officers and directors were likely making important decisions rapidly and under tremendous pressure. In the event of a security event or privacy mishap, those decisions may be second guessed by plaintiffs’ attorneys, with the benefit of hindsight, in shareholder litigation against the board.”

THE RISK OF EPL CLAIMS

COVID-19 has forced company directors to make major decisions about how they operate their businesses. Employees are being required to work differently and in some cases, as a product of their employment, are themselves at a heightened risk to contracting the disease. In some sectors this means directors exercising their best judgement whilst around them relevant legal and regulatory standards relating to their employees are changing.

Taking a global perspective, the law firms agree the risk of future claims against directors will depend of the sectors in which they operate – with perhaps directors of private healthcare, retail and transport companies most exposed. They point to the scope of existing employment/labour rights and the variety of ways in which governments have chosen to legislate in response to COVID-19 and/or issue government guidance as being a source of claims.

Most countries have implemented changes in relation to issues like wage support, grants and loans for companies intended to support the company and its workforce. We also know that travel (including work related travel), social distancing and personal protective equipment are areas where countries have sought to impose new rules for companies to comply with.

Mark Frederick from **Miller Thomson LLP** agrees that COVID-19 may trigger employee and workplace related risks for company directors in **Canada** – “Various statutes outline the duties of employers and directors of employers to employees in the workplace. Directors are required, at the very least, to exercise due diligence to ensure that the corporation is not violating any of these statutes. Some statutes subject directors to penalty sanctions where the director caused or acquiesced to the breach of the organization’s statutory duty to the employee. Directors may also be held personally liable for certain wages and benefits owed to employees in some cases.

COVID-19 means many businesses are in the process of laying-off workers, which may have implications for both unionised and non-unionised business. An aggrieved employee may not accept the lay-off and may decide to bring action for wrongful dismissal, or allege that the lay-off was motivated by discriminatory grounds and seek remedies under provincial Human Rights statutes.”

Perhaps the most notable example so far of state intervention into how companies and their directors are expected to fulfil their legal obligations has been seen in France. In order to protect employee rights companies there have seen the unions take legal action against Amazon to ensure health and safety standards were being met in its warehouses. A decision dated 14 April 2020 was handed down by the civil court of Nanterre (interim judge) ordering Amazon to conduct an assessment of professional risks inherent to Covid-19 pandemic in its premises. Until such assessment is completed, Amazon’s activities should be restricted to the receipt and shipping of essential supplies, subject to a daily fine of €1m in case of non-compliance. This highlights what Sarah Xerri-Hanote from **HMN & Partners** had already foreseen as a risk area for directors – “Despite the restrictions, some companies ask their employees to continue to work. The fact of exposing employees to the risk of contamination, eg not ensuring sufficient protection (failure to provide proper personal protection equipment or to take measures allowing the employees to comply with safety distances) could give rise to actions initiated by employees or their families against the employers’. In addition to existing legal actions, French Labour Inspection has already sent formal notices to companies operating in France (eg FedEx) requiring them to take measures to protect their employees from the risk of contamination. The employers failing to comply with their safety obligations might be exposed to criminal prosecution for reckless endangerment or involuntary manslaughter.”

In the **Netherlands** Marit van der Pool at **Kennedy Van der Laan** explains that: “Currently, EPL-related claims in the Netherlands can only be addressed to the company and not to directors, but we can imagine that after the company becomes insolvent, (former) employees may attempt to claim damages from directors because of serious negligence. This would be new for us, but so is the current crisis.” Whilst it may be claims for bodily injury

are excluded in D&O policies, those insurers might still be exposed to other aspects of the claim, for lost earnings, or to health and safety investigations or prosecutions.

INSOLVENCY RELATED D&O EXPOSURES

Despite many countries implementing government backed schemes providing financial assistance to help companies survive the effects of COVID-19 the world is braced for a global recession. It is difficult not to foresee large scale corporate insolvencies taking place in the coming months.

Insolvency scenarios represent a specific type of litigation risk for directors and their D&O insurers. The steps taken by Governments in, for example (but there are others) the **United Kingdom** and **Australia** are instances though where law makers are attempting to ease the pressure on company directors when their companies are facing financial hardship.

Australia has pushed through the Coronavirus Economic Response Package Omnibus Bill 2020 (the COVID Act), designed to offer protections against the increased risk of insolvent trading claims. The COVID Act introduced temporary relief for directors from their duty to prevent insolvent trading as well as a temporary increase in the minimum amount and time period for statutory demands. The COVID Act also introduced a new insolvent trading ‘safe harbour’ comprising a six-month moratorium on insolvent trading liability in respect of debts incurred ‘in the ordinary course of the company’s business’. The Government has also increased the minimum debt which can form the basis for a statutory demand and the period within which the debt must be paid. These provisions are intended to allow companies to continue to trade even where they are technically insolvent but Keith Bethlehem at **Colin Biggers and Paisley** cautions that this will not exonerate directors from other breaches of duty – in other words, the fact the company continues to trade will not result in a D&O claim but parallel breaches of the statutory duties of care and diligence that a reasonable director would exercise may still give rise to indemnifiable claims.

Italy has enacted the so called “Decreto Liquidità” which include rules – aimed at facilitating companies facing financial difficulties and insolvency – providing for: (i) temporary relaxation of certain important corporate and governance rules dealing with protection of the

company’s share capital; and (ii) temporary changes to certain aspects of insolvency procedures. Anthony Perotto at **Nctm** says these changes may effect the liability exposure of directors but also importantly for insurers push back a significant number of insolvency declarations and, potentially, concentrate a high number of them to a subsequent Year of Account.

Despite these and similar steps being taken by other countries each intended to reduce the risk of corporate insolvencies, insolvencies are happening and will increase. The directors maybe could not have prevented those financial difficulties, but that does not mean claims will not arise. Simon Goldring at **RPC** is reminded of the Warren Buffet quote that “it is only when the tide goes out you get to see who was swimming naked”. In other words, the claims might have nothing to do with coronavirus but the appointment of liquidators will shine a light on past conduct which would otherwise have gone unnoticed and result in claims that would otherwise have not been made.

HOW ARE INSURERS RESPONDING TO COVID-19?

Underwriters are now grappling with the question of whether they should impose specific Covid-19 exclusions, which on the one hand may protect them against future exposures but on the other hand might open them up to blanket notifications and potentially irrecoverable loss of business.

Also, particularly for property risks, an exclusion begs the argument that the prior policies would otherwise cover the losses – this point is flagged by Mark Frederick at **Miller Thomson** in **Canada**: “We do believe that the insurance industry will struggle with adding COVID exclusions, particularly in light of the fear that adding them now will suggest past policies did not exclude these issues. We do expect however that more insurers will be compelled to introduce such exclusions as their re-insurers will definitely not wish to assume liability for the COVID risk.” Where an exclusion is added to the policy there will be debate around its scope. John DeLascio from **Hinshaw & Culbertson** comments that in the **US**: “Courts fairly uniformly read “arising out of or relating to”-type language in insurance policies broadly, even if it appears in an exclusion.

A COVID-specific absolute exclusion in the appropriate broad form would in our view exclude such claims. It also may do a better job of addressing unanticipated types of claims, and clarifying matters for courts which might be inclined to find ambiguities and therefore coverage.”

Keith Bethlehem of **Colin Biggers and Paisley** explains the **Australian** position by reference case law generated in the wake of insolvencies in the cyclical coal and iron ore sectors. “Recent case law in the context of insolvency exclusions in D&O policies mean that there must be a clear causative connection between the insolvency of the company and the claim which eventuates, even with ‘indirectly arising out of’ language. The Courts take a commercial purpose focus in the interpretation of D&O Policies. The theme underlying recent decisions is that D&O insurers must recognise that the very time that directors will turn to the policy is after insolvency and any attempt to limit cover in these circumstances will be read down.

The more aggressive exclusions are likely to need to be specifically disclosed to (prospective) insureds at the risk of being deemed an unusual term which would then make them unenforceable under the Insurance Contracts Act.”

We asked the contributing firms whether the uniqueness and all prevailing nature of COVID-19 could potentially render such exclusions as being unenforceable. In **Italy** where most of the country’s larger corporate insureds are headquartered in the Lombardy, which of course is the area most affected by COVID-19. Anthony Perotto from **Nctm** explains that – “Whilst more vague and tentatively-catch all exclusions (eg “any claims directly or indirectly arising out of the COVID-19 Pandemic” or the like) may be preferable, there is a material risk that such broad and vague exclusions may affect the coverage in a very significant way and give rise to material uncertainties and possibly even effectiveness issues.

We consider that any underwriter should carefully consider the position under the specific wording and take a carefully balanced decision on a wording-by-wording basis. Any new exclusion will have to comply with certain formal requirements (including a specific separate execution under S. 1341 of the civil Code).”

CONCLUSION

Coronavirus does not respect international borders – it has spread fast and globally. There are some countries that have been hit particularly hard by this nasty disease. There are other countries that have been more successful in locking down and controlling its spread. But either way, all countries have been effected economically and socially. How that translates into claims is difficult to predict and will vary from country to country. There is no doubt the road ahead will be bumpy and twisty – so insurers need expert drivers at the wheel to help navigate them through this course.

