BAILEY | CAVALIERI

DAN A. BAILEY
E dbailey@baileycav.com
D 614.229.3213

RECENT D&O CLAIMS DEVELOPMENTS

July 2021

The D&O claims environment is now in an unusually uncertain state. The COVID-19 pandemic has created aberrational D&O claims data, so it is difficult to predict future claims activity based on that data. It seems likely—but not certain—the unusual 2020 claims data will eventually return to the pre-pandemic trends. But it also seems likely the pandemic will, to some extent, leave a longer-term legacy which could materially impact D&O claims.

Added to this uncertainty is the new Biden administration (aided by a Democratic-controlled Congress), which promises to implement increased regulations, more aggressively pursue regulatory enforcement proceedings and support wide-ranging social reforms. Those initiatives seem likely to directly or indirectly impact, at least to some extent, the nature, frequency and severity of D&O claims in various contexts.

The following summarizes many of the more important recent legal developments involving D&O claims. During these uncertain times, it is especially important for those who advise and insure directors and officers to carefully monitor and react to these and other developments.

1. Securities Class Action Litigation. Prior to the COVID-19 pandemic in 2020, the single biggest development relating to D&O claims activity was the resurgence of securities class action litigation. The frequency of this litigation reached a record level in 2019. But, in 2020 the number of securities class actions filed in federal courts decreased by more than twenty percent (20%) when compared to 2019, due in large part to a significant decline in 2020 of federal court merger objection class actions. In addition, litigation activity during the pandemic lessened, further contributing to lower claims numbers.

   The growing pre-pandemic increase of federal M&A-related securities claims and the sudden decline of those suits in 2020 do not reflect a new or changing exposure for directors, but merely reflect a change in litigation strategy by the plaintiffs' bar. In the past, virtually all M&A-related claims were filed in state court alleging breaches of fiduciary duty by the directors of the target company. However, largely because of the *Trulia* decision by the Delaware Chancery Court in January 2016, most plaintiff lawyers now prefer to file merger-related claims in federal court, alleging misrepresentations and omissions by directors and officers in connection with the merger violated federal securities laws, rather than alleging breaches of fiduciary duty by the target's directors and officers. Prior to the

Trulia decision, the vast majority of state court M&A-related claims were quickly settled pursuant to which the company agreed to make some additional disclosures to the shareholders in connection with the transaction and the plaintiff lawyers received a modest fee award. But the Delaware court concluded in *Trulia* that this type of disclosure-only settlement in M&A claims is highly suspect because the shareholders receive very little, if any, benefit from the settlement, yet the shareholders grant to the defendants broad releases. As a result, most M&A-related D&O claims are now filed as securities class actions in federal court, where the plaintiffs' bar hopes to enjoy greater flexibility in structuring settlements. The vast majority of such claims are resolved for little if any financial payment, although cases with compelling conflict-of-interest allegations can have large settlement amounts.

The following summarizes many of the recent substantive developments in securities class action litigation:

a. In 2019 and 2020, the settlement amount in two separate securities class actions against a company and its D&Os exceeded $1 billion each, which was unprecedented. See VAREIT and Bausch Health (fka Valeant) settlements. These settlements suggest a trend toward dramatically increased settlement amounts in at least the most severe cases and perhaps a trickledown increase in settlement amounts in more modest cases as well. For example, in June 2021, a $351 million settlement was announced in the Germany litigation by Volkswagen against several former executives arising out of the company's "Dieselgate" scandal. Four executive defendants personally contributed to the settlement in varying amounts up to $10 million.

b. The plaintiffs and plaintiffs' bar in securities class actions are evolving. Fewer large institutional investors are choosing to serve as lead plaintiff in these cases because they view any benefits from serving in that role to be outweighed by the burden, cost and distractions created by that service. In part because of that development, some of the premier plaintiff law firms in this area have curtailed or largely withdrawn their focus on securities class actions, which has resulted in a number of "second-tier" plaintiff firms becoming more active in this area. For example, since 2018, more than one-half of the non-M&A securities class action lawsuits have been filed by three small "emerging" plaintiff firms. The cases filed by these three firms have been dismissed at much higher rates than cases prosecuted by more experienced law firms. This dynamic is a mixed bag for defendants and insurers. Although these firms at times are less effective litigants, they often have unreasonable settlement expectations.

c. The heightened exposure of directors and officers in connection with an IPO or secondary offering of securities was aggravated by a U.S. Supreme Court decision in March 2018. In *Cyan Inc. v. Beaver County Employees'*

Retirement Fund, the Court ruled that plaintiffs may prosecute claims under the Securities Act of 1933 in either state court or federal court, thereby affirming existing case law in California and rejecting contrary case law in most other jurisdictions. The plaintiffs' bar reacted to this ruling in two ways. First, more securities class actions arising out of a company's initial or secondary offering of its securities are now being filed in state courts throughout the country. This development creates several concerns for defendant D&Os. State courts do not provide the same procedural protections afforded to defendants in federal court securities claims pursuant to the PSLRA, thus encouraging plaintiffs to file relatively weak cases in state court. Because state courts have fewer resources and typically see far fewer securities cases than federal judges, state court securities cases are dismissed by trial courts less frequently than federal cases. As an example, on April 29, 2021, a New York appellate court affirmed a trial court ruling that a state court securities class action sufficiently alleged violations of the Securities Act of 1933. This ruling is in contrast to several other post-*Cyan* decisions by New York appellate courts which dismissed state court securities class actions and may further embolden plaintiffs to continue to file 1933 Act claims in New York state courts. Also, nothing prevents multiple lawsuits alleging the same wrongdoing in multiple state courts or in both state and federal courts, thereby increasing defense costs and creating the risk of inconsistent rulings. Second, 1933 Act state court cases are now settling for materially larger amounts due to this perceived pro-plaintiff forum. But, a March 18, 2020 decision by the Delaware Supreme Court may provide important relief for D&Os in these types of cases. In *Sciabacucchi v. Slazberg*, the court ruled that under Delaware law a bylaw provision which requires any securities lawsuits be filed in federal court (i.e., a federal forum provision or "FFP") is facially valid. Consistent with that Delaware Supreme Court ruling, beginning in September 2020 three California state court decisions dismissed 1933 Act claims filed in state court based on the company's FFP. See decisions in *Wong v. Restoration Robotics, Inc.*; *In re Uber Technologies Sec. Lit.*; and *In re Dropbox, Inc. Sec. Lit.* In light of these recent rulings, all companies contemplating a securities offering should consider adopting a FFP bylaw provision. As of November 2020, more than 125 companies reportedly have done so, either in connection with their IPO or otherwise.

d. The exploding popularity of Special Purpose Acquisition Companies ("SPACs") further increases the D&O liability exposure associated with IPOs. A SPAC is essentially a shell company which raises money through an IPO for the purpose of acquiring another unidentified company during the subsequent two years. Robust disclosures to investors are required both in the SPAC's IPO and in the subsequent acquisition of the ultimate target company, so the risk of someone later criticizing those disclosures (particularly in light of the time limitations and unique circumstances of each disclosure event) is unusually high.

Litigation to date has largely been in state courts alleging the SPAC D&Os breached their fiduciary duties by providing inadequate disclosures regarding proposed de-SPAC transactions. Some of these lawsuits also assert claims against the target company and its D&Os. As of May 2021, over 60 such suits were filed in New York state courts. In April 2021, a securities class action in New York Federal court against Akazoo, its acquiring SPAC and their D&Os settled for $35 million.

The frequency of this litigation seems likely to increase in the coming months as more and more de-SPAC transactions continue to be announced. Plus, in April 2021, the SEC issued a statement highlighting concerns with the appropriate accounting treatment of warrants issued by SPACs. That statement resulted in nearly 500 SPACs restating their financial statements to treat the warrants as liabilities rather than equity. Historically, a company's restatement of its financial statements often gives rise to litigation against the company's directors and officers, as evidenced by at least one such suit (involving Virgin Galactic) being filed during the initial two months following the SEC statement.

e. In several recent securities class action settlements, defendant directors and officers made significant personal payments toward the settlement. For example:

- Steve Wynn personally paid $20 million of a $41 million settlement of securities class action litigation arising out of his alleged pattern of sexual misconduct with employees.

- The CFO of VAREIT personally paid $12.5 million of a $1.025 billion settlement of securities class action litigation involving a restatement of the company's financial statements due to allegedly intentional errors.

- Defendant directors and officers of Tribune Media Company collectively paid personally $45 million of a $200 million settlement of a bankruptcy trustee's claims arising out of the disastrous 2007 leveraged buy-out of the company.

Historically, personal settlement payments by defendant directors and officers of public companies have been quite rare. But, that appears to be changing, particularly where the defendant's conduct is egregious and/or the amount of available D&O insurance to fund the settlement is inadequate (either because the amount of insurance purchased is inadequate or large amounts of defense costs significantly eroded the insurance limits).

2. SEC Enforcement. In addition to private securities litigation, D&Os need to also be concerned about SEC enforcement activity, which has varied significantly in recent years. During the first two years of the Trump administration, SEC enforcement activity involving public companies decreased noticeably. However, during 2019, those enforcement actions returned to record-breaking levels. Then in 2020, SEC enforcement actions dropped to historically low levels, perhaps due in large part to the COVID-19 pandemic. In 2020, 72% of the public company enforcement actions included claims against individuals—most often the CEO or CFO of the company.

   The two main factors which continue to create concern for D&Os in this context are summarized below.

   First, the revolving leaders at the SEC's Division of Enforcement have repeatedly stated that "individual accountability" is one of the Division's "core principles," and that "pursuing individuals has continued to be the rule not the exception."

   Second, during its 2020 fiscal year, the SEC received a record 6,900 whistleblower reports, which was a 31% increase over the prior record in 2018, primarily from insiders at companies who identified illegal behavior. The recent increased frequency of whistleblower reports to the SEC appears to be attributable at least in part to the February 2018 U.S. Supreme Court decision in *Digital Realty Trust, Inc. v. Somers*, in which the Court held that the Dodd-Frank Act's provision which protects whistleblowers against retaliation only applies to whistleblowers who report to the SEC, not to whistleblowers who report internally within their company. As a result, whistleblowers are highly incentivized to report their complaints to the SEC.

   The potential to receive a whistleblower bounty award from the SEC is another strong incentive to report wrongdoing to the SEC. In its 2020 fiscal year, the SEC paid about $175 million in awards to 39 individuals. The number and amount of whistleblower awards during and shortly after the SEC's 2020 fiscal year were record-setting, which apparently reflects the SEC's new efforts to streamline and accelerate the award process. Most noteworthy, in June 2020 the SEC approved a $50 million award and in October 2020 (after the end of its 2020 fiscal year), the SEC approved a $114 million award, each of which was the largest ever for a single person when the award was approved. These large awards continued into 2021. In April two claimants received a $50 million award, in May two claimants received a $27 million award and in June two other claimants received a $23 million award.

   The most common complaints by SEC whistleblowers are disclosure and financial irregularities (25% in 2020), offering fraud (16% in 2020) and manipulation (14%

in 2020), all of which typically implicate directors and offices. These complaints obviously give to the SEC valuable information upon which strong claims against directors and officers can be brought.

SEC enforcement actions can be particularly problematic for D&Os because they frequently last a long time and usually cannot be resolved at the same time as parallel securities class action and shareholder derivative litigation. As a result, a sufficient amount of the company's D&O insurance limits should be preserved following a settlement of the private litigation to fund the ongoing and potentially very large costs in the SEC action.

3. Derivative Suits. Historically, shareholder derivative lawsuits (which are cases brought by shareholders on behalf of a company against D&Os seeking damages incurred by the company as a result of alleged wrongdoing by the D&Os) have presented relatively benign exposures. Although frequently filed in tandem with a more severe securities class action, derivative suits usually have been dismissed by the court or settled for relatively nominal amounts because of the strong defenses available to the D&O defendants. For example, a committee of independent directors who were not involved in the alleged wrongdoing may determine that prosecution of the derivative suit on behalf of the company is not in the company's best interest, in which case the court may dismiss the case. Likewise, the defendant D&Os usually have several strong defenses in the derivative suit, including pre-suit demand requirements, the business judgment rule, state exculpation statutes, and reliance on expert advisors.

Despite these procedural and substantive defenses, an increasing number of derivative suits are now settling for large amounts. The following summarizes many of the more recent "mega" derivative settlements.

Company	**Type of Incident**	**Derivative Settlement**
Wells Fargo	Widespread improper consumer banking practices	$320 million
Alphabet	Alleged culture of sexual discrimination/harassment and mishandling of complaints against senior executives	$310 million diversity and equity fund for governance reforms
VAREIT	Financial statement errors	$286 million
Activision Blizzard	Executive officers unfairly acquired a controlling interest in the company	$275 million
McKesson	Opioid-related wrongdoing	$175 million
News Corp.	Relative of majority owner personally benefitted from acquisition of company; company's employee journalists used illegal reporting tactics	$139 million
AIG	Allegedly fraudulent $500 million reinsurance transaction to mask company losses	$150 million
Freeport-McMoRan	Merger fraught with allegations of sweetheart deals and self-dealing	$137.5 million

Oracle	$900 million in insider trading in advance of disappointing earnings announcement	$122 million
Broadcom Corp.	Options backdating scandal that resulted in $2.2 billion write-down	$118 million
AIG	Allegation that company paid sham commissions to a closely-held insurance agency	$115 million
21st Century Fox	Allegedly rampant sexual harassment by former Fox executives	$90 million
PG&E Corp.	Gas Line Explosion	$90 million
Del Monte Foods	Leverage buyout of company by private equity firms	$89.4 million
Pfizer	Off-label marketing of drugs resulting in federal investigations and claims under the False Claims Act	$75 million
Bank of America	Acquisition of Merrill Lynch based on allegedly false statements about Merrill's losses	$62.5 million

A number of factors appear to be contributing to this troubling trend of large derivative suit settlements, including:

- *Caremark* Erosion. One of the primary substantive defenses for D&Os in many derivative lawsuits is the so-called *Caremark* defense, which in essence says D&Os are not liable for lack of oversight of company operations absent the director or officer engaging in self-dealing, having a conflict of interest or committing gross dereliction of his or her duty. A series of decisions issued over the last couple of years from Delaware courts suggests an erosion of this important defense. In what has been referred to as a "new *Caremark* era," Delaware courts have imposed a heightened duty on directors to oversee "mission critical operations" and to follow-up on "red flags," resulting in courts more often refusing to dismiss cases even when directors have not engaged in self-dealing or overt wrongdoing.

- Duplicate Lawsuits. Unlike most securities class actions which must be litigated in federal court, derivative litigation is usually filed in state court. Also, unlike securities class action litigation, there is no mechanism to consolidate multiple derivative lawsuits into one state court proceeding. As a result, multiple derivative cases, each prosecuted by a different plaintiffs' firm, will often proceed in different courts, even though all of the lawsuits assert essentially the same claims on behalf of the company. This results in higher defense costs, inconsistent court rulings in the parallel cases, and the potential for higher settlement amounts to resolve all of the lawsuits.

- Large Event Exposures. The most troubling recent phenomenon involving shareholder derivative litigation is the increasing frequency of lawsuits arising out of an unexpected event which causes huge financial loss to the company. There is now a higher likelihood that such large company losses will result in a large derivative suit settlement. Although it is tempting to question why directors and officers should be liable for the unexpected event, plaintiffs' lawyers allege that the D&Os could have prevented or at least mitigated the company loss through better management practices. Types of incidents that have or are likely to fuel this type of derivative lawsuit include very large cyber breaches, a large environmental catastrophe, systemic sexual harassment, COVID-19 losses, decommissioning of nuclear plants, large product recalls or product liability claims, gas line explosions and unforeseen oil spills and large-scale energy outages. Equally alarming is the increased frequency of securities class actions arising out of these unexpected events if there is even a modest stock price decline following the event. These disclosure-based lawsuits allege the defendants failed to disclose or downplayed the risks of the event occurring and test the age-old distinction between mismanagement claims (i.e., derivative lawsuits) and disclosure claims (i.e., securities class action lawsuits).

Although large derivative suits typically are based on allegations of classic mismanagement or poor business decisions, which have historically been protected by the business judgment rule, three dynamics contribute to more of these cases surviving that defense and resulting in large settlements:

First, when the losses to the company are extremely large, thereby creating significant harm to shareholders, some state court judges (who are usually elected officials) are reluctant to dismiss the case absent a very compelling justification.

Second, plaintiffs' lawyers can avoid many of defendants' liability defenses by basing their claim on some type of alleged conflict of interest or alleged breach of the duty of loyalty rather than the more common, and harder to prove, breach of the duty of care.

Third, when the derivative lawsuit is prosecuted in state court where the underlying incident occurred, there are often high emotions by local residents who were impacted by the incident and heightened attention by local politicians and media outlets. The judge often either shares that emotion or feels political pressure to respond to that emotion. As a result, these local cases frequently are not dismissed. In light of the huge damages and hostile venue, the D&Os (and their insurers) are then forced to pay exorbitant settlement amounts as the only viable exit strategy in the case.

A forum selection clause in a company's bylaws is an increasingly important tool in defending derivative lawsuits. Under relatively new statutes in Delaware

(Section 115, Delaware General Corporation Law) and a few other states, public companies chartered in those states may adopt a forum selection bylaws provision, which requires all proceedings relating to internal affairs of the company (such as derivative suits) to be filed and adjudicated only in the state designated in the bylaws. Such forum selection bylaw provisions (which are different than the federal forum selection bylaw provisions discussed above for securities claims under the 1933 Act) can prevent multiple derivative lawsuits being prosecuted in multiple and hostile forums.

4. Criminal Proceedings. In recent years, regulators, prosecutors and commentators have repeatedly discussed the importance and purported commitment by the government to hold executives criminally accountable for wrongdoing. In the aftermath of the financial crisis in the late 2000s, there was a large public outcry for the prosecution of responsible individuals. Regulators and prosecutors both then and now repeatedly express the importance of creating individual and corporate accountability through criminal prosecution of executives.

Despite this rhetoric, the prosecution of white-collar crime remains surprisingly infrequent, particularly with respect to directors and senior executives of large public companies where decisions are often made "by committee" without clear attribution to one or a few individuals who possess the necessary intent to violate the law. In addition, prosecutors often have limited resources and usually only bring cases they believe they can win. As an example of these challenges, in January 2021, a federal appeals court overturned the convictions of four former executives of Wilmington Trust, which was the only financial institution criminally charged in connection with the federal bank bailout program following the 2008 financial crisis.

Despite these challenges, numerous recent examples demonstrate that criminal exposure for executives is very real in several circumstances.

First, even in a large public company, senior executives who have direct responsibility for matters which create spectacular losses can be incarcerated. For example, the former CEO and COO of SCANA pled guilty in 2020 to defrauding customers and others with respect to a failed $9 billion nuclear construction project.

Second, lower level executives who more easily can be shown to have knowingly participated in criminal wrongdoing are more frequently prosecuted than senior executives. For example, in 2020 (i) the former medical director of Indivior PLC pled guilty to criminal charges relating to the company's marketing and sale of opioid drugs (following a similar plea by the company's former CEO), (ii) six mid-level executives of Citigo were convicted in Venezuela of corruption charges, (iii) the Senior Vice President of Governmental Affairs of Com Ed pled guilty to charges involving the bribery of governmental officials, and (iv) an executive of Sandoz, Inc. pled guilty to price-fixing charges involving generic drugs. In 2021, a former executive of Netflix was convicted of money laundering and bribery for accepting stock options, cash and gifts from third-party vendors in exchange for lucrative contracts with the company.

Third, individuals who are senior executives (and also large owners) of smaller companies are easier targets of criminal charges because of their more intimate knowledge of company operations. For example, in 2020 (i) executives (who were also partial owners) of DC Solar pled guilty to a billion dollar Ponzi scheme, (ii) the former CEO (and majority owner) of Quanta Dyn Corporation pled guilty to bribery and government contract fraud charges, and (iii) the former CEO and COO of MiMedx Group were convicted of securities fraud in connection with a conspiracy to inflate company revenues. In 2021, the former CEO of Chimera Energy was sentenced to six years in prison for his involvement in a pump-and-dump scheme involving the company.

5. Cyber Claims. Unquestionably, cyber-related losses and claims are one of the most troubling future exposures for companies. It is virtually impossible for companies to prevent cyber attacks. Loss mitigation, rather than loss prevention, seems to be the only strategy available for most companies.

Surprisingly to some, the liability exposure of directors and officers for cyber-related claims is less predictable. Prior to 2017, no cyber-related securities class action lawsuits were filed even with respect to very large and highly-publicized cyber intrusions at large companies. But more recently, plaintiff lawyers have filed a growing number of such securities class actions, including cases against Marriott, Chegg, Google/Alphabet, FedEx, Capital One, First American Financial Corp., Solar Wind, , Yahoo!, Equifax and their D&Os. These cases are still somewhat uncommon despite the large number of companies which experience data breaches because in most cyber attack situations, the company's stock price does not materially drop following disclosure of the attack. But, if there is a material stock drop following disclosure of the cyber breach, a securities class action is likely, and those securities class actions can be expensive. For example, the Yahoo! cyber-related securities class action was settled in March 2018 for $80 million while a motion to dismiss was pending, and the Equifax data breach securities claim was settled in February 2020 for $149 million.

It is far from clear whether these cases will ultimately be successful on a widespread basis. Most of these securities class action lawsuits have been dismissed, primarily because the plaintiffs failed to sufficiently allege the defendants acted with the requisite scienter (i.e., plaintiffs did not allege facts showing the defendants knew the size or impact of the breach at the time of the allegedly incorrect disclosures) or because plaintiffs failed to sufficiently allege either a misstatement or omission of material facts. The likelihood of these cases being dismissed increases if the company's disclosures include detailed and specific cautionary statements about cyber risks and do not characterize the quality of the company's cybersecurity. But, a June 16, 2021 decision by the

Ninth Circuit reversed the lower court's dismissal of the Alphabet/Google cyber securities class action, thereby confirming these cases can create meaningful exposure in certain circumstances.

Shareholder derivative lawsuits against directors and officers are another litigation response when a company suffers large cyber-related losses. However, this type of derivative litigation is also challenging for plaintiffs in light of the business judgment rule, the applicable state exculpatory statute for directors, and other state law defenses for the defendant directors and officers. A cyber incident will rarely involve conflicts of interest, and therefore should rarely give rise to large derivative litigation settlements absent unusual circumstances. But, a few cyber-related derivative lawsuits have recently settled. Most notably, the *Yahoo!* derivative suit settled for $29 million, due in large part to the extraordinary number of people impacted by the breach (i.e., as many as 1.5 billion users) and the two-year delay in disclosing the breach. Other cyber derivative settlements are far smaller, often including a modest plaintiff fee award and the company agreeing to certain governance reforms.

The May 2021 ransomware attack on Colonial Pipeline dramatically elevated the visibility and importance of cyber attacks particularly against companies involved in critical infrastructure or public services. As ransomware becomes the preferred method of cyber attack by criminals, directors and officers are faced with very difficult decisions which can expose them to criticism at best or personal liability – should the requested ransom be paid (thereby quickly ending the disruption caused by the attack), or not paid (thereby discouraging future ransomware attacks)? Because plaintiff lawyers have not been consistently successful to date regarding cyber-related D&O claims, it seems likely these increasingly common ransomware attacks will provide to the plaintiffs' bar a new approach to attacking the conduct of D&Os in this area.

Going forward, cyber-related derivative settlements will likely increase in size if the lawsuits survive a motion to dismiss, based on the increasing losses incurred by companies in this area. Examples of recent huge cyber-related company losses include:

- $700 million settlement by Equifax of consumer class action litigation and regulatory investigations relating to a cyber breach that exposed Social Security numbers of nearly 150 million people.

- $5 billion FTC penalty payment by Facebook and related $100 million SEC settlement in connection with the access of personal data of millions of Facebook users by Cambridge Analytics.

- $230 million fine to British Airways and $124 million fine to Marriott International pursuant to the 2018 General Data Protection Regulation (GDPR) adopted by the European Union.

The area of greatest potential exposure for directors and officers regarding cyber matters does not arise from acts or omissions by directors and officers prior to the attack, but rather from conduct of directors and officers once the attack is identified. Disclosures regarding the scope, effect and cause of the attack, and the response by management immediately following the attack, can potentially create either securities class action or shareholder derivative litigation. Therefore, companies should develop and implement long before a cyber attack actually occurs effective protocols and action plans which describe what should and should not be done if a cyber attack against the company occurs. Careful advanced planning in this area can provide a unique opportunity to minimize the potential personal liability of directors and officers for post-attack conduct.

Although D&O cyber claims typically focus on post-breach conduct, a recent derivative lawsuit against certain directors and officers of Laboratory Corporation of America is an interesting exception. That lawsuit is based in large part on a data breach at one of Lab Corp.'s third party service providers that resulted in the hacker gaining access to personally identifiable information for more than 10.2 million Lab Corp. patients. The derivative lawsuit seeks recovery from the D&O defendants of Lab Corp.'s losses from that breach, including losses incurred in a consumer class action by Lab Corp.'s patients.

Another related D&O exposure in this context is the potential for criminal charges against a director or officer for insider trading based on sales of company stock after the cyber event was discovered, but before it was publicly disclosed. For example, the former chief information officer of Equifax was indicted for insider trading based on his sale of $950,000 of company stock before the company's massive data breach was publicly disclosed.

6. Special Interest Claims. There are now an unprecedented number of D&O claims which arise out of highly publicized social issues. Whether each of those social issues is temporary or long-term, and thus whether the D&O claims arising from each of those social issues are aberrations or a permanent new exposure for D&Os and their insurers, is yet to be seen.

The following summarizes the primary examples of these types of claims. The legal theories asserted in these claims are not new or unusual, but the factors which are causing the claims to be prosecuted are recently developed.

a. COVID-19 Claims. The financial impact to companies and likely claims against companies arising out of the COVID-19 pandemic are staggering and impossible to overstate. The frequency and severity of D&O claims in this context are less predictable, though.

D&O claims directly related to the pandemic to date have not been as significant as some may think. For example, approximately 35 securities class actions have been filed relating to the pandemic, depending on how one defines a COVID-19-related case. The alleged misrepresentations in those suits generally fall into three categories: (i) statements relating to the company's ability to produce COVID-related vaccines, therapies, testing materials, safety equipment, etc. (i.e., disclosures about how the company may profit from the pandemic); (ii) statements relating to the impact of the virus on the company's financial performance, business operations, prospects or risk profile; and (iii) statements relating to the company's receipt or use of federal funds or loans in connection with COVID-19 related programs. Four rulings have been issued so far regarding motions to dismiss in these cases, with three of the cases being fully dismissed (Velocity Financial, Royal Caribbean and Norwegian Cruise Lines) and one case largely surviving the motion to dismiss (Inovio Pharmaceuticals). Even fewer derivative suits have been filed, which typically are in tandem with a related securities class action. Interestingly, the SEC has been particularly active in this context, commencing numerous investigations and enforcement proceedings.

A larger D&O exposure likely arises from "indirect" pandemic-related D&O claims arising out of a company's insolvency or the dramatic stock market volatility attributable to the pandemic. For companies that have the bad luck of disclosing some disappointing news to investors (unrelated to the virus) on the same day as a large stock market drop, there is a high likelihood that securities class actions will be filed against those companies. Plaintiff lawyers will contend those large stock drops in a company's stock price were caused by the disappointing and non-virus disclosures by the company, even though in reality the large stock drop was attributable to the market's overall concerns about the impact of the virus on the economy as a whole. Plaintiffs will argue that their potential recoverable damages in those suits are enormous based on the large stock drop, and thus a settlement of the securities class action should be very large.

From a D&O insurance perspective, the "direct' pandemic claims brought by persons who contract the virus will likely be excluded from coverage by reason of the bodily injury/property damage exclusion and/or the pollution exclusion in D&O policies. But, at least the bodily injury/property damage exclusion may not apply to the shareholder or "indirect" claims because that exclusion typically only applies to claims "for" bodily injury/property damage.

b. <u>#MeToo Claims</u>. It is hard to overstate the scope and effect of the so-called #MeToo movement, both legally and culturally. Following the public allegations of sexual misconduct by Harvey Weinstein beginning in late 2017, virtually every type of industry has experienced allegations of inappropriate or illegal sexual misconduct, and most organizations have adopted or updated their policies and practices in this area.

Not surprisingly, wide-spread publicity of salacious allegations has spawned an increased number of claims against the alleged perpetrator and employers. Most of those claims impact EPL insurance policies rather than D&O insurance policies, but in the more egregious situations, mismanagement and disclosure claims against directors and offices can be and have been filed. For example, a derivative lawsuit on behalf of Alphabet (parent company of Google) based on the company's overall alleged culture of sexual discrimination and harassment and the company's alleged mishandling of sexual harassment allegations against senior executives was settlement in September 2020, pursuant to which a $310 million diversity, equity and inclusion fund was established to implement extensive governance and employment policies. A somewhat similar securities class action against Signet Jewelers International, Inc. settled in March 2020 for $240 million. The settled claims involved unrelated allegations of misrepresentations concerning the company's in-house lending program for customers and alleged sexual harassment by senior executives. Likewise, a derivative suit against 21st Century Fox D&Os arising out of alleged rampant sexual harassment by former Fox executives settled for $90 million. But, a similar securities class action arising out of alleged sexual harassment by senior executives of Papa John's International, Inc., a shareholder derivative lawsuit on behalf of Lululemon Athletica Inc., a securities class action arising out of sexual misconduct by Wynn Resorts CEO Stephen Wynn, and a similar securities class action against Liberty Tax Inc. were dismissed in March, April, May and September 2020.

The frequency of D&O claims in this context dropped significantly beginning in 2019, so the long-term effect of the #MeToo movement on D&O litigation and insurance is now questionable. But a new generation of these types of claims may be emerging. In November 2020, a shareholder derivative lawsuit was filed against directors and officers of Pinterest, Inc., alleging the defendants engaged in, facilitated and knowingly ignored the company's "systemic culture, policy and practice of illegal discrimination on the bases of race and sex." The lawsuit is similar to prior #MeToo derivative lawsuits based on sexual harassment allegations, but is broader in scope by focusing on gender and racial discrimination, not just sexual harassment.

c. Climate Change Claims. Although climate change issues permeate many industries and generate a variety of legal concerns, D&O litigation has been largely immune to those issues. But that may soon be changing. Both the New York and Massachusetts Attorneys General filed separate lawsuits against Exxon Mobil alleging the company deceived investors and consumers about climate-related risks. In December 2019, a jury in the New York Attorney General's lawsuit ruled that Exxon Mobil's climate-related disclosures did not violate the New York state securities fraud statute. That ruling was not appealed. But the Massachusetts Attorney General lawsuit (under the state's consumer protection statute) and a securities class action in Texas (under the federal securities laws) remain pending against the company. Also, shareholders filed related derivative lawsuits against Exxon's directors and officers in Texas and New Jersey. It seems likely these suits are precursors to an increasing number of claims by regulators or shareholders against directors and officers who made or approved the alleged misrepresentations.

Other recent developments confirm the growing credibility and concerns regarding the role of corporations in addressing climate-change issues. For example, in early 2021, an activist shareholder of ExxonMobil successfully elected an advocate for climate-change initiatives to the company's Board and a Dutch court issued an order requiring Royal Dutch Shell to reduce carbon dioxide emissions by 50% of 2019 levels by 2030. A resulting increase in D&O claims in this area seems inevitable.

d. <u>Board Diversity Claims</u>. The Black Lives Matter movement beginning in 2020 and the related sensitivity to racial equality and diversity has impacted virtually all aspects of society, including the business community. Corporations have quickly realized that real and immediate reform in this area is both socially and economically in their best interests. To further emphasize that point, California enacted a statute in September 2020 which requires public companies headquartered in California to include on their board of directors at least one representative of "underrepresented communities," such as persons who are Black, African-American, Hispanic, Latino, Asian, Native American, gay, bisexual or transgender. Some other states, including Illinois, Maryland and New York, require companies to disclose the minority composition of their Boards in either publicly-available government filings or annual reports to shareholders. These statutes are similar to an earlier California statute enacted in 2018 which requires corporations headquartered in California to have a minimum number of females on their boards of directors. Although no known D&O claims have been asserted (yet) based on a company's non-compliance with these statutes, several cases are pending which attack the constitutionality of these statutes.

However, independent of these diversity statutes, a series of shareholder derivative lawsuits has been filed in California beginning in 2020 against directors and officers of corporations with little if any diversity on their boards of directors and in senior management. Examples include lawsuits involving Oracle, Facebook, Qualcomm, Norton Life Lock, Danaher Corporation, Monster Beverage and The Gap. These lawsuits, which have been principally filed by the same law firm, allege the companies misrepresented and failed to follow their publicly proclaimed commitment to diversity as it applies to their boards and executive officers. Early indications are these derivative lawsuits will likely be unsuccessful in most instances. For example, the lawsuits involving Oracle, Facebook and The Gap were dismissed by courts, based at least in part on the company's Delaware forum selection clause in its bylaws. The plaintiffs' bar seems to recognize Delaware courts will likely not be a friendly forum for these lawsuits.

Although the legal merits of—and recoverable damages in—these claims are debatable, the cases serve as a stark reminder that companies must conform their public statements to their actions, and vice versa.