

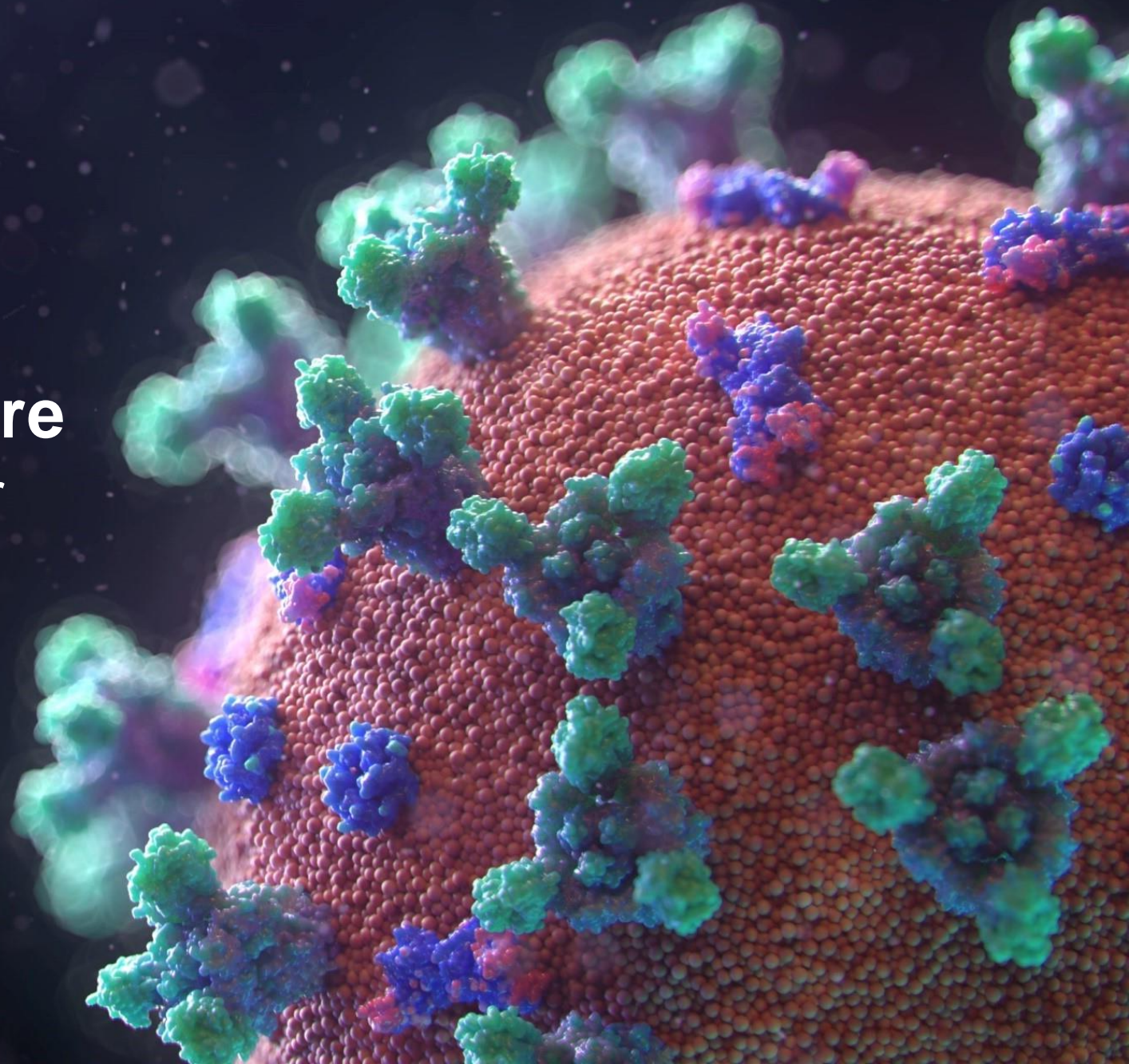


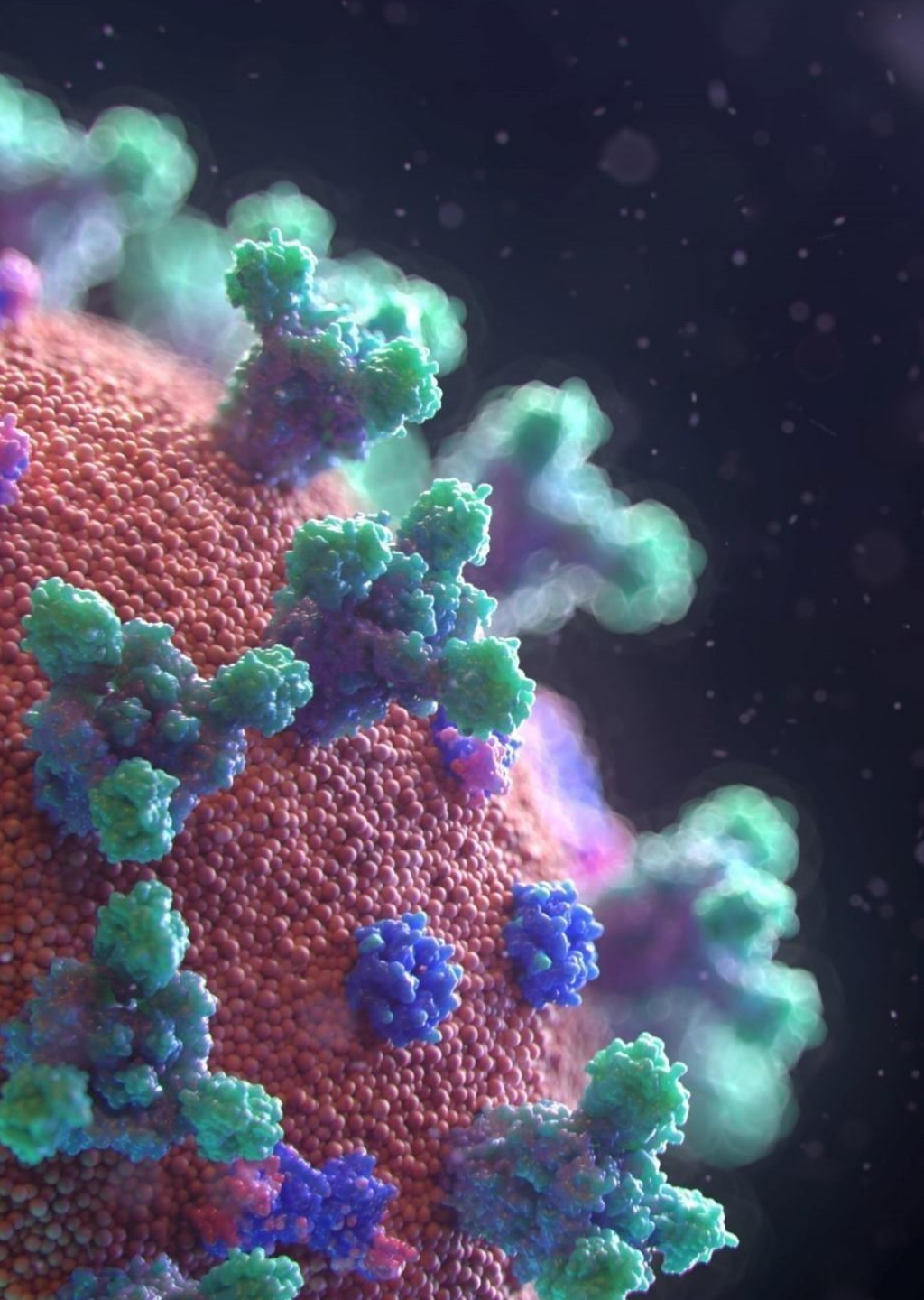
COVID-19 Legal Exposure for Public Companies and their Directors & Officers

April 21, 2020

Seyfarth Shaw LLP

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Recent COVID-19 Securities Lawsuits



Recent COVID-19 Securities Lawsuits

- A cruise line allegedly knowingly used deceptive sales tactics and minimized COVID-19 risks resulting in materially false public disclosures and an inflated stock price.
 - This is a securities class action based on a misrepresentation of sales practices, including false statements by its sales force about the virus and its impact on the cruise industry.





Recent COVID-19 Securities Lawsuits

- A pharmaceutical company allegedly misrepresented the status of its progress in developing a COVID-19 vaccine which improperly inflated its stock price.
 - This is a classic securities lawsuit based on alleged misrepresentations regarding a product in development.



Recent COVID-19 Securities Lawsuits

- A video telecommunications company allegedly knowingly failed to disclose and misrepresented its privacy and security weaknesses; when the COVID-19 outbreak resulted in increased use of the company's services, those weaknesses became apparent and the company's share price dropped over 20%.
 - This is a securities class action based on alleged misstatements and omissions in SEC filings, including purportedly insufficient cautionary language concerning forward looking statements in offering documents, 10Qs, and 10Ks.

Potential COVID-19 Related Lawsuits: Disclosure-Related Lawsuits



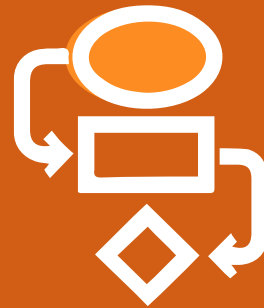
SEC Guidance

- On March 25, 2020, the SEC's Division of Corporation Finance released guidance indicating that it believes that disclosures for public companies affected by COVID-19 are required under the securities laws.
- While the SEC recognizes that predicting the precise impact of COVID-19 on business operations is difficult and that the actual impact will depend on factors outside the company's control or current knowledge, the SEC expects a company to disclose its analysis of material risks to its business from COVID-19 and its response to those risks.
- The SEC also recommends that companies proactively revise and update disclosures as facts and circumstances change.

SEC Guidance

- The analysis of risks performed by public companies should include, *inter alia*, risks associated with:
 - Operational disruptions
 - Liquidity issues and conditions in loan agreements or other financing agreements that are implicated by COVID-19
 - Valuation of assets
 - Demand for product/service and supply chain issues
 - Internal control weaknesses, vulnerabilities, threats
 - Workforce/labor disruptions
 - Increased cybersecurity threats, vulnerabilities and stresses to controls with significant expansion of remote work

Hypothetical 1





Hypothetical 1

- Protectivewear Inc., a Delaware corporation listed on the New York Stock Exchange, manufactures protective gear, including hospital-grade face masks that it advertised were 99% effective in shielding germs and viruses. Its factories are located all over the world but its largest factory is located in Wuhan, China.
- What COVID-19 issues should Protectivewear think about as it makes its financial disclosures?

Forward-Looking Statements

- As a general matter, statements clearly identified as forward looking and accompanied by “meaningful” cautionary language are not actionable under securities laws.
- The Private Securities Litigation Reform Act of 1995 protects against liability with respect to forward-looking statements “containing (a) projections of revenues, income, earnings or other financial items[,] (b) the plans and objectives of management for future operations, (c) future economic performance, and (d) assumptions underlying or relating to such matters.”

Meaningful Cautionary Language

Meaningful cautionary statements are those that identify important factors that could cause actual results to differ materially from those in the forward-looking statement.

A black and white photograph of a person standing at a podium, gesturing with their hands while speaking to an audience. The scene is dimly lit, with the speaker and the podium in the foreground and the audience in the background.

“

COVID-19 poses a risk to all businesses.

”

Meaningful Cautionary Language

Meaningful cautionary statements are those that identify important factors that could cause actual results to differ materially from those in the forward-looking statement.



“

We face the risk of operational disruptions due to potential factory shutdowns or decrease in available workforce.

”

Puffery or General Statements of Optimism

“Puffery,” or general statements of corporate optimism, are not actionable under Section 10(b) and Rule 10b-5 because they are “too general to cause a reasonable investor to rely on them.”

“

We have confidence
in our business model

”



Puffery or General Statements of Optimism

“Puffery,” or general statements of corporate optimism, are not actionable under Section 10(b) and Rule 10b-5 because they are “too general to cause a reasonable investor to rely on them.”



“

We are confident in our ability to survive this crisis.

”

Puffery or General Statements of Optimism

- Statements that might be innocuous puffery standing alone may be actionable when used to emphasize a material representation or where specific details are included to support the general claim.
- In addition, companies must be careful because “misstatements of existing facts” are actionable even if they otherwise would be mere “puffery.”

Puffery or General Statements of Optimism

“

We expect our new plant to immediately begin production of our product.

”



“

We are facing difficulties ramping up the new plant for large scale production.

”



Statements of Opinion

- Sincerely held statements of pure opinion do not give rise to liability under Section 11 of the Securities Act of 1933, which provides for strict liability in connection with misstatements or omissions in a registration statement.
- Plaintiff must plead more than that an opinion turned out in retrospect to be incorrect.
- Following the Supreme Court's guidance, circuit courts have held that the *Omnicare* standards apply not only to Section 11 claims but also to claims under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.



Statements of Opinion

- An issuer does not have a “general disclosure requirement” to reveal its basis for an opinion. However, “the expression of an opinion may carry with it an implied assertion, not only that the speaker knows no facts which would preclude such an opinion, but that he does know facts which justify it.”
- A statement of opinion “is not necessarily misleading when an issuer knows, but fails to disclose, some fact cutting the other way.”
- “Reasonable investors understand that opinions sometimes rest on a weighing of competing facts.”
- “A reasonable investor does not expect that every fact known to an issuer supports its opinion statement.”

Is Good Faith Belief in Truth of Statement a Defense?

- Courts have identified three theories of liability with respect to opinions:
- **Material misrepresentation:** Plaintiff must allege both that “the speaker did not hold the belief she professed” and that the opinion is objectively untrue.
- **Embedded statement of fact:** Plaintiff must allege an opinion contains a statement of fact that is materially misleading.
- **Omission:** Plaintiff must allege facts that relate to the basis for the opinion whose omission makes the opinion misleading.

Is Good Faith Belief in Truth of Statement a Defense?

“

We are implementing safety measures at our factories and believe that our workers are adequately protected.

”

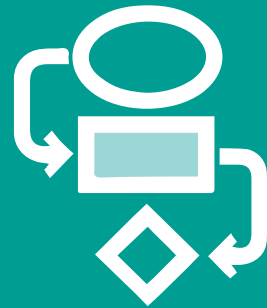


“

The factory is over-crowded and there is not enough protective gear to go around!

”

Hypothetical 2





Back to our hypothetical company, Protectivewear

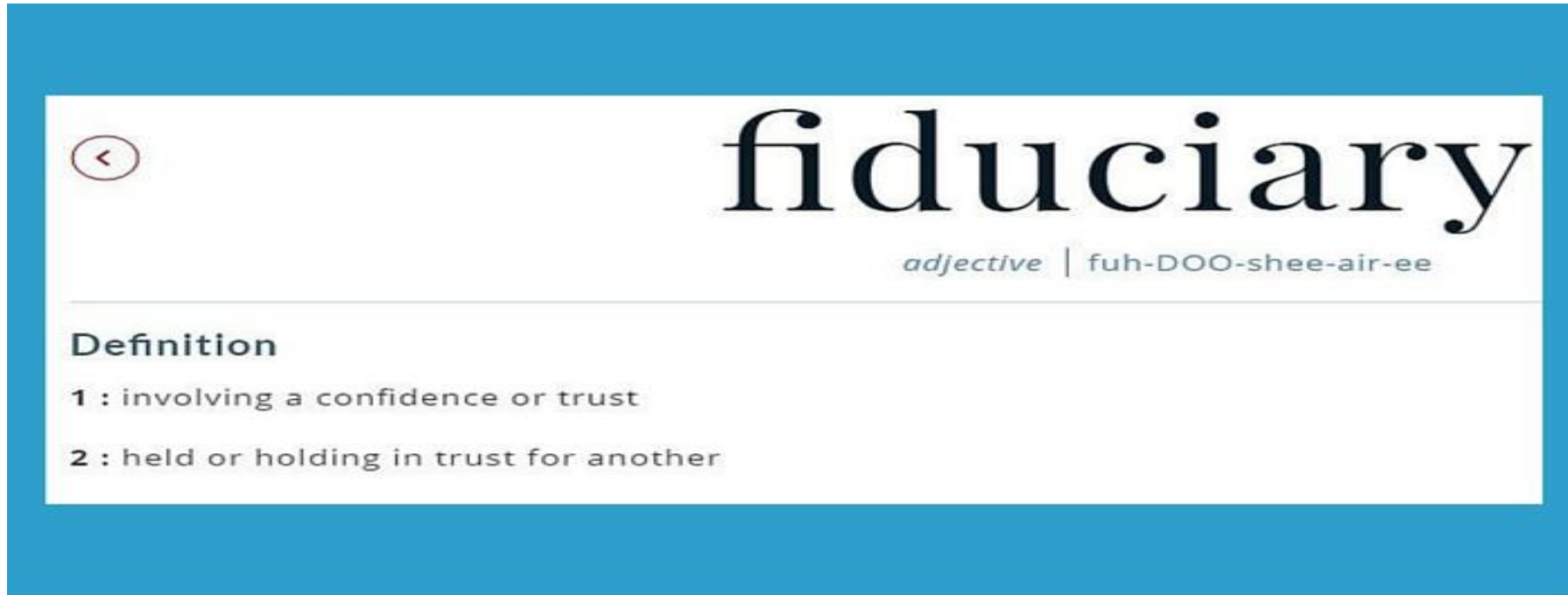
- In March 2020, Protectivewear announced to investors that it was actively managing the crisis and that it expected a seamless transfer of production from its factory in Wuhan to a large plant in Michigan that was operational and that would be the key production site for the Company going forward.
- Protectivewear's CEO announced that he was confident that the Company would be able to meet the increased demand for its product and that the Company would see increased revenues for 2020.
- Several quarters later, a manufacturing defect was discovered at the Michigan plant resulting in defective masks that did not adequately protect users from the virus. Protectivewear was forced to issue broad recalls and was faced with numerous consumer class action lawsuits.
- In addition, an outbreak of COVID-19 among workers in Protectivewear's Michigan plant led to a shutdown of the factory.
- Upon this news, Protectivewear's stock price fell 35%, and institutional investors filed a putative class action in federal district court.


Potential COVID-19 Related Lawsuits: Breach of Fiduciary Duty Claims



Breach of Fiduciary Duty Claims

- What Are the Duties Owed By Board Members?
 - Care
 - Loyalty

A screenshot of a dictionary entry for the word "fiduciary". The word is written in a large, black, serif font. Below it, the word "adjective" is written in a smaller, italicized font, followed by a vertical line and the phonetic transcription "fuh-DOO-shee-air-ee". Below this, the word "Definition" is written in a bold, black, sans-serif font. Underneath the definition, there are two numbered entries: "1 : involving a confidence or trust" and "2 : held or holding in trust for another". The entire screenshot is set against a blue background with a white border.

 **fiduciary**
adjective | fuh-DOO-shee-air-ee

Definition

1 : involving a confidence or trust

2 : held or holding in trust for another

Board Oversight Duties



- What Type of Oversight Must The Board Perform?
 - *Caremark*
 - Ensure company has appropriate internal reporting systems in place such that appropriate information will come to Board’s attention in timely manner
 - Implement and monitor reasonable system of internal controls
 - Good faith effort to monitor and exercise oversight

Board Oversight Duties



- Liability Where Board:
 - (1) completely fails to implement any reporting or information system or controls, or
 - (2) having implemented a system of controls and reporting, materially fails to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

Board Oversight Duties



- Steps To Avoid Liability - *Marchand* (Prong 1)
 - Create committees
 - Establish protocols requiring management to keep Board apprised of compliance practices, risks, and reports
 - Have board meetings concerning set up of protocols and material risks
 - Set regular schedule for reports on compliance risks
 - Formulate procedures for the communication of *red or yellow flags*
 - Arrange for regular discussions of compliance risks

Board Oversight Duties



- Steps To Avoid Liability - *Clovis Oncology Derivative Litigation* (Prong 2)
 - Must implement oversight and reporting AND monitor those systems to ensure that significant red flags are appropriately addressed
 - Because of greater scrutiny more attention is required in highly regulated industries

Event Driven Litigation and COVID-19

- Since 2018 - Dramatic Increase In D&O Claims Arising Out Of:
 - Employment claims
 - Cyber security concerns
 - Privacy protections
 - Disappointing results
 - Operational difficulties
 - IPOs
- 2020 - COVID-19
 - Some theories of securities cases likely to be event driven (consider video telecommunications case)
 - Matters arising out of COVID-19, e.g., insurance coverage changes, regulatory changes (including the CARES Act)



Are You Covered/Protected?

- **D&O Insurance Considerations**
(Past and Current Policies)
 - Underwriting challenges
 - Cost
 - Exclusions
 - Timing of renewal
- **Insolvency Duties/Considerations**

Takeaways



Takeaways

Takeaways

For Board and Directors

- Cyber security protections
- Information flow and increased frequency of Board meetings
- Succession planning
- Insurance policies
- Active liquidity/debt-management
- Worker protections
- Internal Controls
- Documentation

Takeaways

Takeaways

- Assess carefully the company's risks
 - Fundamental, COVID 19, industry specific, organization specific
 - Distinguish between contingencies and risks that have already materialized

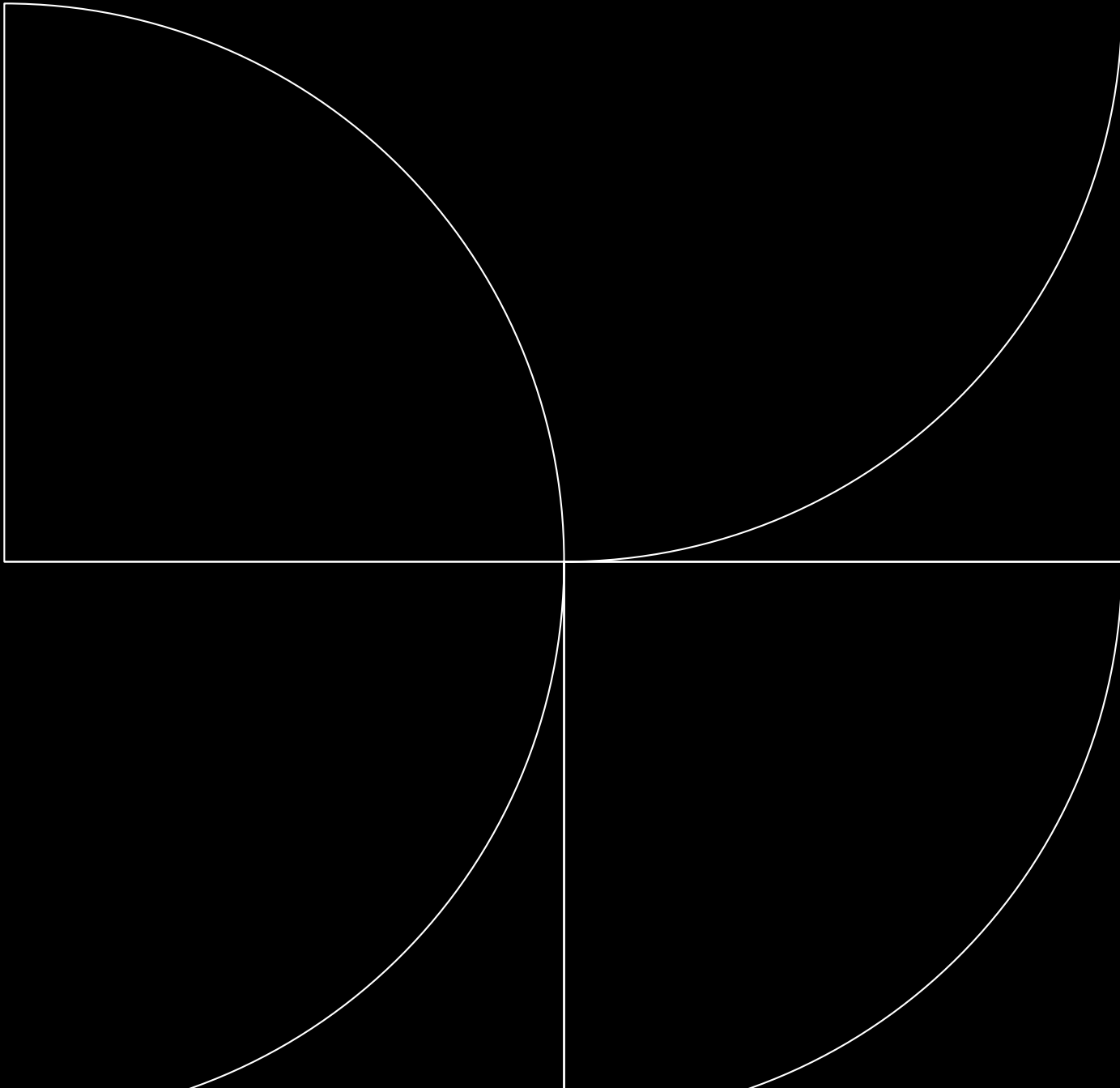
Takeaways

Takeaways

- Expand the list of risk contingencies in light of COVID-19.
 - Document a plan to address any material risks. Implement and monitor and document
 - Proactive-measures
 - COVID-19 committees
 - Succession/continuity planning
 - Increased frequency of Board meetings
 - Ensure Information flows to those who need to know
 - Protection of confidential information during remote work and make regular cyber security evaluations
 - Assess compensation and operational changes to protect company health
 - Assess liquidity/debt-management
 - Adopt protections for employees, internal controls, processes
 - Evaluate corporate disclosures, insider trading, and financial risks

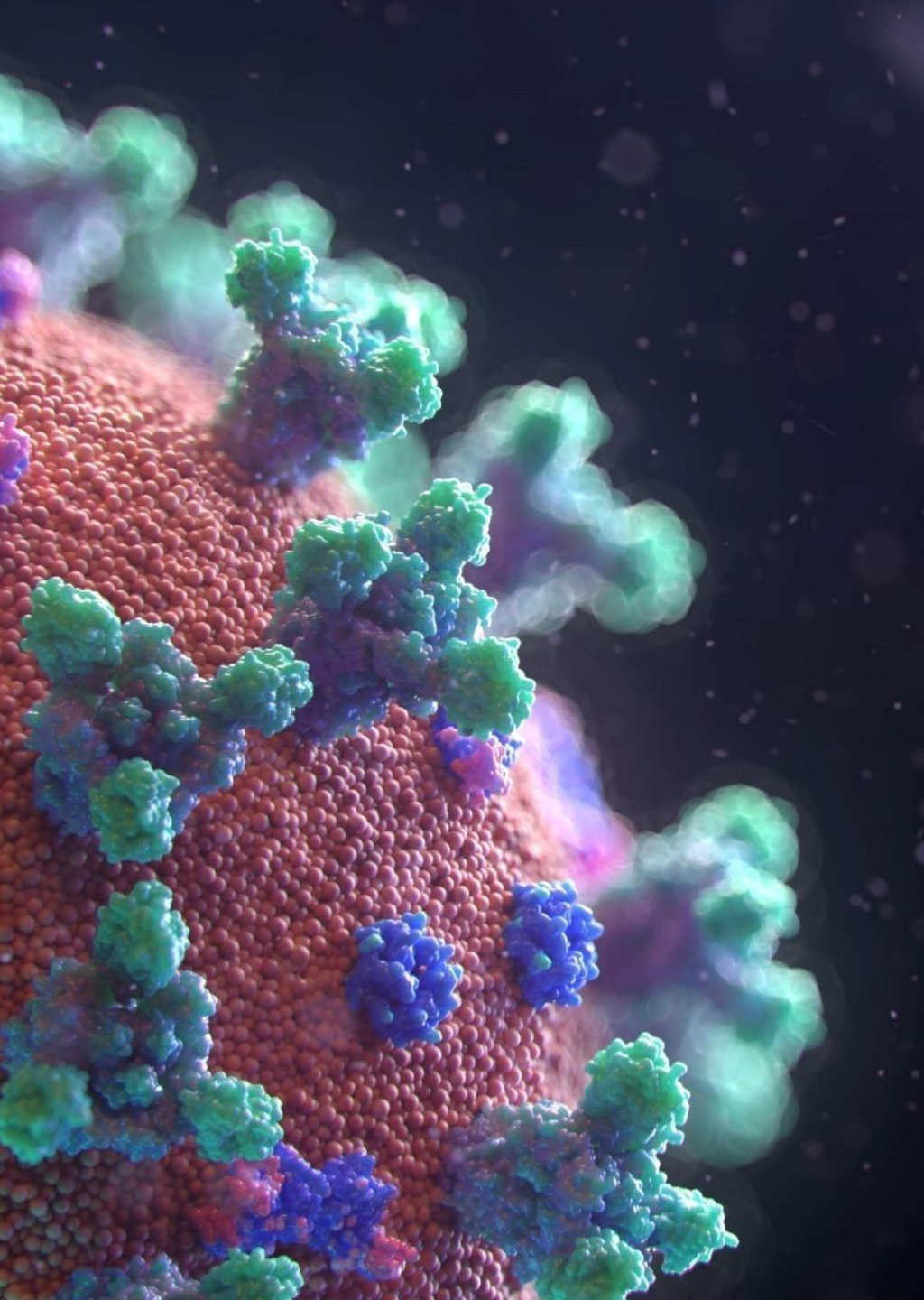
Takeaways

- Adopt the habit of using language that identifies predictions or forecasts and indicates that they are uncertain, particularly in the context of the current crisis.
- Opinions should be identified as such, supported by facts, and not omit or conflict with information that render the opinion misleading.
- Forward looking statements should be carefully identified and should include appropriate and specific cautionary language and identify specific risks and contingencies.



Questions?

Thank you



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