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Shareholder Litigation and COVID-19: Risks Facing Directors and Officers of Public Companies

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In recent years, plaintiffs attorneys have attempted to exploit certain disruptive events — including environmental disasters and cybersecurity breaches — as opportunities to bring securities fraud and derivative lawsuits against public companies. The COVID-19 pandemic is no exception.

Based upon the early flurry of lawsuits tied to the pandemic, shareholders appear to be targeting public companies in certain sectors — especially health care, pharmaceutical, tourism and technology. A review of these cases indicates a few trends in the types of allegations being put forth by shareholders, including allegations that companies have: (1) made overly optimistic statements; (2) failed to disclose or concealed deficiencies; or (3) made false or misleading statements about the pandemic's impact. By familiarizing themselves with the types of COVID-19-related allegations raised in these recent complaints, directors and officers of public companies will be better positioned to address investors' concerns and mitigate the risk of shareholder litigation. Of course, the recent strength in the stock market could impact the likelihood of future filings.

Positive or Optimistic Statements in Light of the COVID-19 Outbreak

Many of the COVID-19-related shareholder lawsuits have alleged that certain public companies and their executives have made overly positive or optimistic statements about (1) their ability to financially weather the pandemic or (2) newly developed products designed to combat the pandemic.

Indeed, the first complaints containing COVID-19-related claims alleged that a cruise line misled investors by presenting a positive outlook about its booked position this year, despite the known impact of COVID-19. According to shareholders, this positive outlook was misleading in light of news reports allegedly revealing that sales personnel were told to downplay customers' concerns about the pandemic, so as to preserve bookings.

Shareholders have similarly targeted companies (and their executives) in the health care and pharmaceutical industries. Specifically, shareholders filed a putative class action against a pharmaceutical company, alleging that the company misled investors after the CEO announced the development of a viable COVID-19 vaccine — a development that was later discredited. This alleged misstatement

also led to a derivative suit against the company's directors, alleging (among other claims) breaches of their fiduciary duties for allegedly causing and failing to correct the CEO's statement. Similarly, a biotechnology company announced that it had been selected to receive government support for the development of a COVID-19 vaccine. But shareholders filed suit, alleging that the company made false or misleading statements, after a newspaper revealed that the company was not among those receiving significant government funding.

A health care company was also sued by shareholders after its CEO allegedly described a newly discovered antibody as a "cure" for COVID-19. Shareholders alleged that this statement was false or misleading after the release of a report casting doubt upon the purported discovery. And another health care company faces both shareholder and derivative actions, alleging (1) that the company made false or misleading statements about the company's ability to fulfill a purchase order for a significant amount of rapid test kits and (2) that current and former board members, inter alia, breached their fiduciary duties by failing to correct such statements.

Misleading or Incomplete Statements About COVID-19's Impact

In addition to focusing on optimistic statements, shareholders have also brought claims alleging that companies misled them about the extent to which COVID-19 has negatively impacted their business.

For instance, following a failure to make interest payments on corporate debt, shareholders sued a Canadian holding company that invests in cannabis cultivators, alleging that the company misled investors about its financial condition. The company attributed these missed payments to a lack of liquidity caused, in part, by COVID-19's impact on market conditions. Shareholders also sued an animal health company, which allegedly did warn the investing public that COVID-19 could cause revenue declines, but allegedly failed to disclose its potential impact on inventory backlogs.

Shareholders have also cited allegedly inadequate disclosures about the pandemic's impact on planned mergers. Indeed, ahead of a proposed tie-up of two entertainment technology companies, shareholders of one of the companies claimed that its directors breached their fiduciary duties. In addition to the allegedly inadequate disclosures, the shareholders also claimed that the directors breached their fiduciary duties by failing to reevaluate the transaction in light of the pandemic. Similarly, shareholders have accused a cybersecurity company of failing to disclose that a planned merger with a private equity firm was in jeopardy due to the private equity firm's concerns about COVID-19's impact on the company's financial condition.

Further, a putative class action was filed against a Chinese real estate firm that recently went public, alleging that the company's IPO documents failed to disclose COVID-19's impact on its real estate operations in China. Notably, shareholders in this case not only targeted the company and its executives, but also the underwriters of the IPO.

Alleged Failure to Disclose or Concealment of Deficiencies

Plaintiffs attorneys are also alleging, with increased regularity, that companies failed to disclose — or even concealed — financial or operational deficiencies that have been exacerbated by COVID-19.

For example, shareholders recently accused a cruise line of making false or misleading statements after news reports revealed that the company had allegedly concealed information regarding its handling of the pandemic. Specifically, shareholders highlighted these news reports to allege, among other things, that the company failed to disclose or conceal (1) that medics had reported increased COVID-19 infections on the company's ships and (2) the amount and severity of these infections.

Shareholders have also sued a company in the video conferencing business, accusing it of making misleading statements about the efficacy of its data privacy and security measures. Although these allegations are not directly related to COVID-19, they arise from increased scrutiny on video conferencing services that the workforce has relied upon during the pandemic.

How Can Directors and Officers Mitigate Litigation Risk?

In light of the nature of the shareholder claims related to COVID-19 asserted thus far, public company officers and directors could consider whether to address the following items.

Risk Factors: Companies may want to evaluate their risk factor disclosures regarding the assessment of and plans for addressing COVID-19-related risks to their business and operations. Such risks may include disruptions due to "stay-at-home" orders or the closure of manufacturing facilities. These disruptions may also result from travel restrictions or changes in consumer behavior. Due to the uncertainty surrounding COVID-19, it may be difficult to ascertain whether the impact will be "material" at the time of disclosure.

Forward-Looking Statements: The SEC has publicly encouraged companies to include forward-looking statements that detail known trends or uncertainties surrounding COVID-19. To maximize

the protections afforded by the Private Securities Litigation Reform Act's safe harbor provision, and thus mitigate litigation risk, it is important that forward-looking statements are identified as such and are accompanied by meaningful cautionary language (i.e., tailored, specific cautionary statements that disclose risks that may materialize).

Role of the Board of Directors: Boards of directors are taking an active role in overseeing their companies' management of the COVID-19 crisis. This includes making strategic decisions and overseeing the implementation of these strategies. As such, companies may consider disclosing the board's role in managing material risks related to COVID-19.

Maintain Adequate Insurance: As the recent uptick in shareholder actions has shown, COVID-19 can significantly increase directors' and officers' exposure to litigation. Because of this increased risk, it is extremely important for directors and officers to assess the sufficiency of their coverage.

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