

What Cos. Should Know About D&O Policy Landscape In 2022

By **Christina Lincoln** (January 27, 2022)

As the U.S. enters its third year of the global pandemic, professionals within the directors and officers, or D&O, liability insurance space are hypothesizing what 2022 may hold in light of the preexisting hard market, as well as new macro trends brought about by COVID-19 and other developments.

Though no one has a crystal ball to predict the future, certain exposures are capturing the attention of the industry as key issues to follow in 2022.



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Antitrust-Related Enforcement Activity

2021 saw increased governmental scrutiny of anti-competitive behavior by companies, which is expected to continue through 2022.

In addition to new leadership taking office at the Federal Trade Commission and the U.S. Department of Justice's Antitrust Division, President Joe Biden issued an executive order outlining proposals for addressing competitive issues within the marketplace.[1]

Further, the FTC and DOJ launched a joint public inquiry on Jan. 18 "soliciting public input [over the next 60 days] on ways to modernize federal merger guidelines to better detect and prevent illegal, anticompetitive deals in today's modern markets." [2] This effort is intended to address the recent surge in merger filings, which more than doubled from 2020 to 2021. [3]

The FTC also has issued several broad policy changes, including lower reportability limits, [4] warning letters issued to companies that complete mergers before FTC investigations are done, [5] and the repeal of the FTC's 1995 announcement that it would not routinely require prior approval and notice provisions in future merger consent orders. [6]

Individual warning letters continue to be issued to companies under the COVID-19 Consumer Protection Act — the 11th round of which was sent on Jan. 19 to companies making unsubstantiated claims about the effectiveness of their products and therapies in the treatment and/or prevention of COVID-19. [7]

Such activity is separate from the multiple antitrust bills being introduced at both federal and state legislatures. [8]

Overall, we can expect the FTC's antitrust-related enforcement activity to continue and possibly increase in 2022.

For example, depending on the scope of the amendments to the merger guidelines, an insured's plans for a future merger transaction may more easily trigger the FTC's presumption of competitive harm based on the existing market concentration within the insured's industry, which in turn may flag an inquiry from the FTC.

Though a form of this presumption exists under the current guidelines, potential amendments include a reevaluation of concentration thresholds and whether qualitative metrics also could trigger the presumption.

In general, a higher risk for potentially triggering enforcement activity under the forthcoming guidelines translates into an increased risk for accompanying D&O claims.

Whether costs incurred in responding to a governmental investigation are actually covered under a D&O policy will depend on the terms and conditions of each insured's policy.

Likewise, if a company's stock price later drops in response to the inquiry, shareholders may file a corresponding securities class action against the company and/or its board of directors.[9]

Activity Related to Special-Purpose Acquisition Companies

As Max H. Bazerman and Paresh Patel explain in *Harvard Business Review*, special-purpose acquisition companies, or SPACs — also called blank check companies — are

publicly traded corporation[s] with a two-year life span formed with the sole purpose of effecting a merger, or "combination," with a privately held business to enable it to go public.[10]

A core benefit is the initial public offering timeline, which is closer to three to five months instead of the usual nine to 12 months for a traditional IPO, along with less regulation and fewer disclosure requirements.[11]

According to SPACInsider, the number of SPAC IPO transactions has skyrocketed over the past couple of years.[12] This in turn has translated into dozens of federal securities class actions, over a dozen shareholder derivative lawsuits and a couple of U.S. Securities and Exchange Commission enforcement actions filed in 2021.[13]

Because the triggering events for these lawsuits have focused on the announcement and/or completion of the SPAC IPO transaction,[14] we can anticipate that D&O claims will remain an area of focus in 2022, given the sheer volume of SPAC IPOs completed in 2020 and 2021, and the fact that as of Jan. 27, 591 SPACs are currently searching for a merger target.[15]

Moreover, the SEC increased its involvement with SPACs in 2021 by issuing a flurry of guidance relating to shell company restrictions; internal control and books and records requirements; internal listing standards for national securities exchanges; and financial reporting and auditing considerations for companies merging with SPACs, among other issues.[16]

John Coates, then-acting director of the SEC's Division of Corporation Finance issued a statement last April, commenting that the expedited process provided by SPACs may lead to "some significant and yet undiscovered issues." [17]

On Dec. 9, 2021, SEC Chair Gary Gensler opined as to the types of SPAC rules he asked the SEC to consider, such as increased disclosure requirements and obligations for SPAC gatekeepers — e.g., sponsors, financial advisers, etc. — and further preinvestment disclosures, e.g., conflicts, expected equity dilution, fees, etc.[18]

This activity, along with an uptick in recent investigations,[19] signposts the SEC's intent to review recent and future SPAC IPO transactions with additional scrutiny.

Direct and Secondary Impact Pandemic-Related Lawsuits

With the world's economy still combating the implications of the latest COVID-19 variant, omicron, a look into 2022 reveals continued D&O claims arising from both direct and secondary effects of the ongoing pandemic.

In 2020 and 2021, dozens of direct-effect securities class actions were filed against companies suffering from COVID-19 outbreaks, companies suffering financially or operationally due to the pandemic generally, and companies developing products or treatments in response to COVID-19.[20]

This is separate from the filed derivative lawsuits and SEC enforcement actions related to COVID-19.[21]

While direct lawsuits related to COVID-19 continue to be filed in 2022,[22] D&O lawsuits involving the secondary effects of COVID-19 — such as supply chain disruptions caused by seaport backlogs, shortage of truck drivers or otherwise — may become more prominent.

For example, on Dec. 14, 2021, a securities class action was filed against Sleep Number Corp. due to its failure to properly disclose the impact supply chain disruptions had on the company's operations, including the continuation of such disruptions, the lack of proper infrastructure to address the disruptions, the inability to meet rising customer demand and the delay in shipping purchases to customers, which delayed millions in revenue to later quarters and affected the company's financials.[23]

Likewise, while current labor shortages have also had some impact,[24] whether and how D&O claims are affected by other trends — such as the current real estate boom, which is expected to continue at a slowing pace, and economic inflation, which reached 7% in December 2021[25] — remains an open question.

For example, if real estate values decrease to match pre-COVID-19 levels, and company stock prices drop as a result, shareholders may analyze the sufficiency of risk disclosures and earnings guidance associated with a company's real estate portfolio and/or investments with others within the real estate or financial industries.

Likewise, as to inflation, to the extent share prices are affected, shareholders may review (1) the activities of a company's board of directors to determine how the company is being protected against rising inflation, and (2) the scope of any disclosures to investors regarding the potential material effects inflation could reasonably have on revenues and operations.

Cybersecurity Breaches and Regulatory Compliance

In a world where hybrid and work-from-home arrangements are becoming the new normal, cybersecurity risks will continue to be an area of interest in 2022 — especially as weekly cyberattacks against companies increased by 50% on average in 2021.[26]

Notably, despite the fact that securities class actions and derivative suits arising from cybersecurity issues are not as common as other exposures, data breaches, as well as regulatory investigations and/or fines imposed due to noncompliance, continue to be key triggering events for such lawsuits.

This includes the derivative suit filed on Nov. 29, 2021, against certain board members of T-Mobile USA Inc., as well as the company itself as a nominal defendant, following a data

breach.[27]

Lastly, cybersecurity lawsuits can be high profile and lead to large settlements, as was the case with Equifax Inc., which settled in 2020 for \$149 million.[28]

D&O Coverage Issues

While coverage under a D&O policy will vary according to the individual terms and conditions, securities class actions, shareholder derivative claims and governmental investigations are claims that typically fall within the scope of the insuring agreement under a D&O policy. However, certain exclusions and provisions must be carefully reviewed in assessing the potential for coverage.

For example, for antitrust claims, the language of the criminal conduct exclusion — i.e., dishonest, fraudulent, malicious and criminal acts — should be reviewed to determine whether its application requires a final adjudication exhausted by appeal or only "in fact" confirmation of such conduct.

Likewise, an antitrust exclusion may vary as to whether it carves out coverage for defense costs or otherwise limits the exclusion to the company only.

As to SPACs, because a new public company's insurance is often separate from its prior private premerger policy, availability of coverage for premerger private company conduct should be assessed carefully, given that (1) D&O claims are often triggered upon the completion of SPAC IPO transactions, and (2) private company policies may include securities exclusions.

For claims related to COVID-19 involving an outbreak at a facility, the language of any bodily injury exclusion should be reviewed for its breadth — e.g., claims "arising from" bodily injury vs. claims "for" bodily injury — as well as any exceptions to that exclusion, such as securities actions.

As to cybersecurity and privacy, to the extent a cyber event triggers a securities class action, there are a number of exclusions, including those discussed above, that require consideration, such as the exclusion for war or terrorism in the event of a cyberattack.

There have been instances in which cyberattacks have been orchestrated by state actors, quasi-state actors and terrorist organization criminal enterprises, as opposed to random, lone wolf actors.

Overall, though the D&O landscape continues to evolve,[29] these exposures and initial coverage issues serve as top-of-mind considerations as we kick off 2022 and work through the days ahead.

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[1] Executive Order on Promoting Competition in the American Economy, The White House (July 9, 2021), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/>.

[2] Federal Trade Commission and Justice Department Seek to Strengthen Enforcement Against Illegal Mergers, Federal Trade Commission (Jan. 18, 2022), available at <https://www.ftc.gov/news-events/press-releases/2022/01/ftc-and-justice-department-seek-to-strengthen-enforcement-against-illegal-mergers>.

[3] Id.

[4] HRS threshold adjustments and reportability for 2021, Federal Trade Commission (Feb. 17, 2021), available at <https://www.ftc.gov/news-events/blogs/competition-matters/2021/02/hsr-threshold-adjustments-reportability-2021>.

[5] FTC Adjusts its Merger Review Process to Deal with Increase in Merger Filing, Federal Trade Commission (Aug. 3, 2021), available at <https://www.ftc.gov/news-events/press-releases/2021/08/ftc-adjusts-its-merger-review-process-deal-increase-merger>.

[6] Statement of the Commission on Use of Prior Approval Provisions in Merger Orders, Federal Trade Commission (July 21, 2021), available at https://www.ftc.gov/system/files/documents/public_statements/1597894/p859900priorapprovalstatement.pdf.

[7] With Omicron Variant on the Rise, FTC Orders More Marketers to Stop Falsely Claiming Their Production Can Effectively Prevent or Treat COVID-19, Federal Trade Commission (Jan. 19, 2022), available at <https://www.ftc.gov/news-events/press-releases/2022/01/omicron-variant-rise-ftc-orders-more-marketers-stop-falsely>.

[8] See, e.g., S.225 - Competition and Antitrust Law Enforcement Reform Act of 2021, 117th Congress (introduced Feb. 4, 2021), available at <https://www.congress.gov/bill/117th-congress/senate-bill/225?q=%7B%22search%22%3A%5B%22archives%22%5D%7D&r=62&s=1>; H.R.5376 - Build Back Better Act, 117th Congress (introduced Sept. 27, 2021), available at <https://www.congress.gov/bill/117th-congress/house-bill/5376>; Senate Bill S993A, The New York State Senate (Jan. 6, 2021), available at <https://www.nysenate.gov/legislation/bills/2021/S933>.

[9] For example, on December 3, 2021, shareholder derivative suits were filed against certain directors and officers of Google and its parent alleging that the defendants caused the company to "systematically engage in anticompetitive acts," thereby resulting in enforcement actions by the DOJ and 48 state attorney generals, and testimony before the U.S. House of Representatives. This cost the company potentially billions in fines and millions on investigations and civil actions. See Kevin LaCroix, Alphabet's Board Hit with Antitrust Enforcement Follow-On D&O Lawsuits, The D&O Diary (Dec. 7, 2021), available at <https://www.dandodiary.com/2021/12/articles/shareholders-derivative-litigation/alphabets-board-hit-with-antitrust-enforcement-follow-on-do-lawsuits/#more-22404>.

[10] Max H. Bazerman and Paresh Patel, SPACs: What You Need to Know, Harvard Business Review (July-Aug. 2021), available at <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

[11] Id.

[12] In summary, 2019 had 59 SPAC IPOs with \$13.6B in gross proceeds and an average IPO size of 230.6M; 2020 had 248 SPAC IPOs with \$83.3B in gross proceeds and an average IPO size of \$336.2M; and 2021 had 613 SPAC IPOs with \$162.5B in gross proceeds and an average IPO size of \$265.1M. SPAC IPO Transactions: Summary by Year, SPACInsider: SPAC Statistics (as of Jan. 15, 2022), available at <https://spacinsider.com/stats/>.

[13] See Kevin LaCroix, The Top Ten D&O Stories of 2021, The D&O Diary (Jan. 3, 2022), available at <https://www.dandodiary.com/2022/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2021/>.

[14] See, e.g., Case Summary: Talkspace, Inc. Securities Litigation, Stanford Law School: Securities Class Action Clearinghouse (last visited Jan. 24, 2022), available at <https://securities.stanford.edu/filings-case.html?id=107865>.

[15] SPAC Status by Year of IPO, SPACInsider: SPAC Statistics (as of Jan. 24, 2022), available at <https://spacinsider.com/stats/>.

[16] Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies, SEC: Division of Corporation Finance (Mar. 31, 2021), available at <https://www.sec.gov/corpfin/announcement/staff-statement-spac-2021-03-31>; Paul Munter, Financing Reports and Auditing Considerations of Companies Merging with SPACs, SEC (Mar. 31, 2021), available at <https://www.sec.gov/news/public-statement/munter-spac-20200331>.

[17] John Coates, SPACs, IPOs and Liability Risk under the Securities Laws, Securities and Exchange Commission (Apr. 8, 2021) available at https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws#_ftnref12; Dave Michaels, SEC Official Warns on Growth of Blank-Check Firms, Wall. St. J. (Apr. 7, 2021), available at <https://www.wsj.com/articles/sec-official-warns-on-growth-of-blank-check-firms-11617804892?mg=prod/com-wsj>.

[18] See Thomas Franck, SEC chair Gensler seeks tougher SPAC disclosure, liability rules, CNBC (Dec. 9, 2021), available at <https://www.cnbc.com/2021/12/09/sec-chair-gensler-seeks-tougher-spac-disclosure-liability-rules.html>.

[19] See, e.g., David Welch, The SEC Puts the Bakes on SPAC-Mania Among EV Makers, Bloomberg Businessweek (Dec. 10, 2021), available at <https://www.bloomberg.com/news/articles/2021-12-10/sec-regulators-draw-scrutiny-to-wall-street-spac-mania-among-ev-makers>.

[20] Kevin LaCroix, The Top Ten D&O Stories of 2021, The D&O Diary (Jan. 3, 2022), available at <https://www.dandodiary.com/2022/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2021/>.

[21] Id.

[22] See, e.g., Class Action Complaint, Case No. 1:22-CV-00101 (E.D.N.Y. Jan. 6, 2022); Class Action Complaint, Case No. 3:22-CV-00105 (N.D.Cal. Jan. 7, 2022).

[23] See Kevin LaCroix, Supply Chain Disruption Leads to Securities Suit Against Mattress Manufacturer, The D&O Diary (Dec. 15, 2021), available

at <https://www.dandodiary.com/2021/12/articles/securities-litigation/supply-chain-disruption-leads-to-securities-suit-against-mattress-manufacturer/>; Complaint for Violations of the Federal Securities Laws, Case No. 0:21-CV-02669 (D.Minn. Dec. 14, 2021).

[24] See, e.g., Case Summary: ATI Physical Therapy, Inc. Securities Litigation, Stanford Law School: Securities Class Action Clearinghouse (last visited Jan. 15, 2021), available at <https://securities.stanford.edu/filings-case.html?id=107784> (Complained filed in August 2021 against a national outpatient physical therapy company alleging that the defendants failed to disclose the company "was experiencing attrition among its physical therapists," that it "faced increasing competition for clinicians in the labor market," and that it "faced difficulties retaining therapists and incurred increased labor cost," among other allegations.).

[25] United States Inflation Rate, Trading Economics (last visited Jan. 15, 2022), available at <https://tradingeconomics.com/united-states/inflation-cpi#:~:text=In%20the%20long-term%2C%20the%20United%20States%20Inflation%20Rate,percent%20in%202023%2C%20according%20to%20our%20econometric%20models> ("The annual inflation rate in the US accelerated to 7% in the last month of 2021, a fresh high since June of 1982, in light with market expectations and compared to 6.8% in November.").

[26] 2022 Security Report, Check Point (last visited Jan. 24, 2022), available at <https://blog.checkpoint.com/2022/01/21/2022-security-report-software-vendors-saw-146-increase-in-cyber-attacks-in-2021-marking-largest-year-on-year-growth/>.

[27] Verified Stockholder Derivative Complaint, Case No. 2:21-CV-1599 (W.D.Wash. Nov. 29, 2021).

[28] Jennifer Bennett, Equifax, Investors Get Final OK for \$149 Million Hack Settlement, Bloomberg Law (July 2, 2020), available at <https://news.bloomberglaw.com/us-law-week/equifax-investors-get-final-ok-of-149-million-hack-settlement>.

[29] This includes the ever-evolving legal landscape. See, e.g., *First Solar, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. CVN20C10156MMJCCLD, 2021 WL 2563023, at *6 (Del. Super. Ct. June 23, 2021) (granting the insurers' motions to dismiss because two actions (filed in 2015 and 2012) were "fundamentally identical," meaning the 2015 lawsuit "predate[d] the inception of the policies" and was barred by the "relatedness" exclusion). This decision was appealed and will be heard by the Delaware Supreme Court in early 2022.