CARLTON FIELDS

D&O Coverage for Coronavirus Claims

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Introduction
Almost overnight, the coronavirus pandemic has disrupted every aspect of "normal." Its impact on the insurance industry will be significant. Businesses and individuals have suffered huge economic losses. It is certain that policyholders will seek to recover those losses from insurers. Indeed, the courts are already inundated with a wide array of coverage claims and the litigation can be expected to last years. The majority of early lawsuits have focused on first-party claims in which policyholders attempt to recover for business interruption. However, policyholders can be expected to pursue every possible avenue to alleviate the economic consequences of the coronavirus. Although pandemics, historically, have not contributed to an increase in D&O claims, several lawsuits claiming damages for breach of D&O policies have already been filed. The purpose of this article is to describe the issues that insurers will face when evaluating coronavirus claims for D&O coverage.

Overview of D&O Coverage

D&O coverage is a relative "newbie" in the insurance world - the first D&O policy was written in the 1930s by Lloyd's of London. The product became more available in the 1960s when Delaware enacted legislation authorizing corporations to purchase insurance to protect directors and officers from lawsuits arising from their corporate service. The need for coverage increased after a 1985 Delaware decision holding directors and officers liable for business decisions related to a corporation or its assets. Since 2000, claims arising from corporate bankruptcies and D&O misconduct (e.g., Enron) together with legislation regulating corporate activity (e.g., Sarbanes-Oxley) have significantly increased the need for D&O coverage.

Unlike other policy types, there is no "standard" D&O coverage form; however, it is customary for D&O policies to be written on a claims-made basis. Each insurer has developed its own language to describe the coverage and the exclusions from that coverage. The lack of standard policy language, the potential for litigation in every state, and the dearth of case law authority make it difficult to

predict the result of D&O coverage litigation in the coronavirus arena. The uncertainty of established precedent is compounded by the fact that D&O policies offer different types of coverage.

- **Side A Coverage**. Every D&O policy provides Side A coverage designed to insure corporate directors and officers from claims made against them regarding the performance of their corporate duties. Former officers and directors are also usually covered for conduct occurring while they were serving the corporation. Side A coverage evolved to protect directors and officers because in many situations they were not entitled to indemnification from the corporate entity.
- **Side B Coverage**. Side B coverage was developed to provide protection for loss suffered by the corporations that did indemnify directors and officers for claims alleging wrongful acts.
- **Side C Coverage**. Side C coverage protects the corporation from claims made against the entity itself. Side C coverage may or may not be available to the entity if the directors and officers have not also been sued, depending, of course, on the policy language.

Insuring Clauses

Typically, D&O policies contain broad insuring clauses, i.e., they pay "loss" arising from any "claim" made during the policy period by reason of any "wrongful act." The policy definitions of those terms may become the focus of coverage litigation. More often than not, D&O policies do not impose the duty to defend on the insurer. "Loss" is usually defined as the amount the insured is obligated to pay for judgments, settlements, and defense expenses. The typical definition of "wrongful act" is broad - "an actual or alleged error, omission, misleading statement, misstatement, neglect, or breach of duty" committed by the officer or director acting in his or her capacity, or by the entity. Given the breadth and lack of specificity of the insuring clauses, the specific wording of the policy exclusions often becomes the focus of D&O coverage litigation.

Policy Exclusions

Common D&O exclusions include "fraud, criminal, or dishonest acts," "breach of contract," "personal profit," "civil fines or penalties," and "insured v. insured," none of which are likely to be implicated in a claim for damage arising from the coronavirus. However, other exclusions may be at issue.

Potentially Applicable Exclusions

D&O policies contain a variety of exclusions that may bar, or limit, coverage for claims related to the coronavirus, depending on the facts of a particular claim and the law in the applicable jurisdiction.

Additionally, it is important to note that the preamble language of an exclusion can impact the interpretation of the exclusion. A discussion of the most commonly used preamble language in D&O policy exclusions and examples of different exclusions follows.

Importance of Preamble Language - "For" vs. "Arising Out Of"

D&O exclusions typically use two different types of preamble language:

1. Some exclusions state that "the Insurer shall not be liable for that portion of Loss under this Coverage Section on account of any Claim ... **for**" certain allegations or circumstances.
2. Other exclusions state that "the Insurer shall not be liable for that portion of Loss under this Coverage Section on account of any Claim: ... **alleging, based upon, arising out of, or attributable to**" certain allegations or circumstances.

Courts tend to interpret "arising out of" broadly and "for" narrowly when construing exclusions For example, Florida case law construes "arising out of," when used in an exclusion, as "broader in meaning than the term 'caused by' and means 'originating from,' 'having its origin in,' 'growing out of,' 'flowing from,' 'incident to' or 'having a connection with.'" *Taurus Holdings, Inc. v. U.S. Fid. & Guar. Co.*, 913 So. 2d 528, 539 (Fla. 2005). The term "requires some causal connection, or relationship," that is "more than a mere coincidence," but "it does not require proximate cause." *Id.* at 539-40. The Florida Supreme Court has noted that most other states similarly interpret "arising out of" more broadly than proximate cause. *Id.* at 535-36 (citing cases from various jurisdictions).

Conversely, in *Snohomish County v. Allied World National Assurance Co.*, 276 F. Supp. 3d 1046 (W.D. Wash. 2017), a Washington federal court held that an exclusion for "claims ... **[f]or** bodily injury ... arising out of a wrongful act ... whether causing or contributing to such bodily injury" did not bar coverage for a loss of consortium claim. *Id.* at 1058-61. The court noted that, "without some form of death or bodily injury, there is no cause of action for loss of consortium," and explained that, "whatever a loss of consortium claim is, it is *not* a claim *for* bodily injury." *Id.* at 1059. The court held that "for," as used in the exclusion, was narrower in meaning than "because of" or "which derive from." *Id.* at 1059.

Other courts have similarly interpreted "for" in a narrow fashion, or deemed it ambiguous, and thus construed "for" in favor of the insured. *See Farmers Tex. Cty. Mut. Ins. Co. v. Zuniga*, 548 S.W. 3d 646, 652-53 (Tex. App. 2017) (interpreting "for," as used in an insuring agreement, to mean "in exchange as the equivalent of"); *Greenwood Cemetery, Inc. v. Travelers Indem. Co.*, 232 S.E. 2d 910, 913 (Ga.

1977) (holding that "for," as used in an insuring agreement, was ambiguous and would be construed in favor of the insured).

In light of these general rules, the exclusions in the policies that use "for" in the preamble are likely to be interpreted more narrowly than ones that use "alleging, based upon, arising out of, or attributable to." Of course, further research and analysis should be conducted on a case-by-case basis because there can always be exceptions to the foregoing general rules, depending on the particular facts, exclusion language, and state law at issue.

Bodily Injury/Property Damage Exclusion

D&O policies typically provide that the insurer "shall not be liable for that portion of Loss under this Coverage Section on Account of any Claim ... for any actual or alleged bodily injury, sickness, disease, death, mental anguish or emotional distress ... or damage to or destruction of any tangible or intangible property, including loss of use thereof, whether or not such property is physically injured."

This exclusion appears to bar coverage for claims against insureds that seek solely to recover damages for bodily injuries or property damage related to the coronavirus. However, because the exclusion applies to claims "for" bodily injury, not claims "arising out of" bodily injury, it may not exclude claims that involve bodily injuries but are not seeking to recover for those injuries directly. This is especially true given that at least one court has indicated that the exclusion may be ambiguous. *SeeSnohomish*, 276 F. Supp. 3d at 1058-61 (holding that exclusion of "claims ... [f]or bodily injury" did not bar coverage for a loss of consortium claim and indicating, without definitively declaring, that the exclusion may be ambiguous in the context of determining coverage for loss of consortium claims).

For example, it can be argued that this exclusion would bar coverage for a patient's lawsuit against a hospital alleging that the patient contracted the coronavirus while in the hospital for an unrelated illness due to the hospital's negligence. On the other hand, it can be argued that the exclusion does not bar coverage for a shareholder's suit against the directors and officers alleging that the hospital corporation suffered damages because the directors, officers, and hospital corporation negligently managed coronavirus protocols resulting in numerous claims, loss of corporate prestige, and a decline in stock value.

Professional Services Exclusion

D&O policies may exclude coverage for a wrongful act in the performance or rendering of, or the failure to perform or render, any professional service. Obviously, coverage will be determined by the interpretation of the policy's definition of "professional services."

Rosalind Franklin University of Medicine & Science v. Lexington Insurance Co., 8 N.E. 3d 20 (Ill. App. Ct. 2014), is an example. In that case, the insured hospital sought coverage under its D&O policy for a lawsuit brought by former patients alleging damages because the hospital decided to discontinue an experimental breast cancer vaccine program. The court held that the policy's medical or professional malpractice exclusion barred coverage for the lawsuit because the decision to shut down the vaccine program was based on specialized medical knowledge, and thus the hospital's exercise of judgment constituted a professional service. The court did not accept the hospital's contention that it was entitled to coverage because the claimants alleged fraud and misrepresentation in terminating the program and did not assert a medical professional decision.

It should be noted that the professional services exclusion in *Rosalind* contained the broad "arising out of" preamble wording rather than the narrow "for." Also, some courts have found certain defined "professional services" terms to be ambiguous. *See, e.g.*, *Am. Guar. & Liab. Ins. Co. v. Leflore Cty.*, No. 4:05-cv-00109, 2006 WL 1134229, at *2 (N.D. Miss. Apr. 24, 2006).

Organization Liability Exclusions

Some policy exclusions apply only to Side C coverage for the organization. They generally bar coverage for loss on account of any claim "alleging, based upon, arising out of, or attributable to":

X X X

> "[A]ny actual or alleged breach of any contract or agreement, except and to the extent the Organization would have been liable in the absence of such contract or agreement."

X X X

> "[A]ny infringement, misappropriation or violation of any patent, service marks, trade secrets, title or other proprietary or licensing rights or intellectual property of any products, technologies of services."

X X X

> "[A]ny goods or products manufactured, produced, processed, packaged, sold, marketed, distributed, advertised, or developed by the Organization."

These exclusions are likely to defeat D&O coverage for a variety of lawsuits against corporate entities, especially because of the broad "arising out of" language. For example, the contract exclusion will bar coverage for claims based on corporate default caused by the negative impact of

the coronavirus on the insured's financial capacity. The intellectual property exclusion will preclude coverage for infringement and misappropriation in suits arising from the corporation's efforts to develop products that will be beneficial in dealing with the pandemic.

Claims Made Issues

D&O policies provide "claims-made and reported" coverage rather than occurrence coverage, i.e., policies only cover claims first made against an insured during, not after, the policy period. However, D&O policies have the potential to provide coverage for post-policy claims pursuant to a "notice of circumstances" provision. Most D&O policies permit the insured to submit a notice of circumstances to the insurer during the policy period identifying a "wrongful act" that may trigger a claim after the policy ends. Given the broad definitions of "wrongful act" and "arising out of," notices of circumstances serve as a "place holder" reserving the policy's coverage for future claims that otherwise would not be covered.

As a result of the pandemic, directors and officers are currently being forced to make significant decisions to help their companies stay in business and successfully emerge from the crisis. While these decisions may not trigger immediate claims, they could lead to future claims, especially for companies that end up in bankruptcy. Therefore, policyholders will likely submit notices of circumstances in an effort to obtain coverage for potential claims under current policies, especially because of concerns that renewal policies will include broad exclusions for claims related to the coronavirus. Indeed, some policyholder law firms are already advising their clients to submit notices of circumstances under their current policies to avoid the anticipated exclusions in future policies.

To protect against potential future exposure triggered by notices of circumstances, insurers should promptly review the notices to determine whether all the requirements for such notices are met. For example, a typical policy may provide:

1. The notice must be in writing.
2. The notice must provide:
    1. "A description of the wrongful act allegations anticipated";
    2. "The identity of the potential claimants";
    3. "The circumstances by which the insureds first became aware of the Wrongful act";
    4. "The identity of the insureds allegedly involved";
    5. "The consequences which have resulted or may result"; and
    6. "The nature of the potential monetary damages and non-monetary relief."

3. The notice must be given to the insurer "as soon as practicable" during the policy period (or extended reporting period, if elected).

4. The notice must involve "facts or circumstances" of which any insured "first became aware" during the policy period (or extended reporting period, if elected) and "which may reasonably give rise to a future claim covered under [the D&O] Coverage Section."

5. The notice must be given to the insurer at the address designated in the policy.

If the notice fails to comply with the policy's requirements, an insurer may not be obligated to cover post-policy period claims. *See, e.g.*, *Nat'l Union Fire Ins. Co. of Pittsburgh v. Underwriters at Lloyd's, London*, 971 So. 2d 885, 889 (Fla. 3d DCA 2007) (holding, under Florida law, that there was no coverage for post-policy period claims because the notice failed to provide all the information required by the policy, including "the consequences which have resulted or may result [from the wrongful act identified in the notice]," and the "circumstances by which the Assureds first became aware [of the wrongful act]").

It is prudent for insurers to raise defects in notices of circumstances when they are received. The insurer should promptly advise the insured, in writing, of the specific defects and reserve the right to deny coverage based on the defects. In some jurisdictions, the failure to respond may bar an insurer from later contesting coverage based on defects in the notice. *See, e.g.*, *JPMorgan Chase & Co. v. Travelers Indem. Co.*, 22 Misc. 3d 1111(A), 880 N.Y.S.2d 224 (Sup. Ct. 2009), *aff'd*, 73 A.D.3d 9, 897 N.Y.S.2d 405 (2010) (holding, under New York law, that the insurer waived objections to the sufficiency of the notice of circumstances where the insurer first raised those objections as affirmative defenses in the coverage lawsuit, even though the insurer "communicated a boilerplate reservation of rights" upon receiving notice).

Potential Coverage Issues Related to Multiple Claims

Given the impact of the coronavirus, directors, officers, and their corporations may have numerous claims during multiple policy periods. Adjusting multiple claims involves unique risks for insurers and also opportunities to mitigate exposure.

Interrelated Wrongful Acts Provision

The interrelated wrongful acts provision in most D&O policies may increase or decrease an insurer's exposure, depending on the governing law and the nature of the claims.

The interrelated wrongful acts provision typically provides:

All Claims arising out of the same Wrongful Act and all Interrelated Wrongful Acts shall be deemed to constitute a single Claim and shall be deemed to have been made at the earliest of the following times, regardless of whether such date is before or during the Policy Period:

- The time at which the earliest Claim involving the same Wrongful Act or Interrelated Wrongful Act is first made; or
- The time at which the Claim involving the same Wrongful Act or Interrelated Wrongful Act shall be deemed to have been made.

Most policies define interrelated wrongful acts to mean "all wrongful acts that have as a common nexus any fact, circumstance, situation, event, transaction, cause or series of facts, circumstances, situations, events, transactions, or causes." Depending on the jurisdiction, the standard for determining whether wrongful acts are sufficiently similar to qualify as interrelated wrongful acts can vary significantly.

For example, Delaware law may require wrongful acts to be "fundamentally identical" to qualify as interrelated wrongful acts. *See Pfizer Inc. v. Arch Ins. Co.*, No. CVN18C01310PRWCCLD, 2019 WL 3306043, at *7-10 (Del. Super. Ct. July 23, 2019). Conversely, New York law appears to apply a less stringent "sufficient factual nexus" test. *See id.* at *7; *Seneca Ins. Co. v. Kemper Ins. Co.*, 133 F. App'x 770, 772 (2d Cir. 2005). Under Mississippi law, there seems to be a viable argument that wrongful acts qualify as interrelated wrongful acts as long as they involve just one common "fact, circumstance, situation, event, transaction, [or] cause," regardless of the number of other differences. *See Associated Indus. Ins. Co. v. Brad Williams, LLC*, No. 3:17-cv-00037, 2018 WL 2308767, at *3, *6 (S.D. Miss. May 21, 2018).

Many courts view the definition of interrelated wrongful acts as being unambiguous; however, at least one court has found a similar definition to be ambiguous and construed the provision against the insurer. *See Connect Am. Holdings, LLC v. Arch Ins. Co.*, 174 F. Supp. 3d 894, 902 (E.D. Pa. 2016) (ambiguous); *but see XL Specialty Ins. Co. v. Perry*, No. 2:11-cv-02078, 2012 WL 3095331, at *5 (C.D. Cal. June 27, 2012) (unambiguous); *Brad Williams, LLC*, 2018 WL 2308767, at *3-4, *8 (same).

Given the varying interpretations of interrelated wrongful acts, insurers may have a choice whether to contend that multiple claims arise out of interrelated wrongful acts or separate wrongful acts. Therefore, it is important to carefully consider the implications of multiple claims being deemed a single claim or separate claims. Having multiple claims be deemed one claim may be beneficial in some situations and detrimental in others. For example, consider the following hypothetical situations involving "Claim 1," made in Policy Period 1, and "Claim 2" made in Policy Period 2, with both claims arising out of interrelated wrongful acts related to the coronavirus:

1. **Beneficial** - A different insurer is on risk in Policy Period 1. Pursuant to the interrelated wrongful acts provision, Claim 2 should be deemed made in Policy Period 1 and thus not covered under the current policy. This approach eliminates or reduces an insurer's exposure.

2. **Detrimental** - An insurer is on risk in Policy Periods 1 and 2; however, Policy 2 excludes coronavirus claims. If Claim 2 is deemed made in Policy Period 1, both claims are covered under that policy. The insurer does not get the benefit of the exclusion for Claim 2. The insurer does, however, get the benefit of a single policy limit for both claims.

Handling Multiple Claims With Exposure in Excess of Policy Limits

The coronavirus impact may potentially cause an insurer to be faced with a situation in which insureds present multiple, high-exposure claims in a single policy period, thus making it impossible to settle all the claims within the available policy limits. Depending on the specific circumstances and the applicable state law, this situation may increase an insurer's risk of bad faith claims. For example, a Florida appellate court has stated that, if a liability insurer controls the defense of an insured against multiple claims arising from a single accident, the insurer must "minimize the magnitude of possible excess judgments against the insured by reasoned claim settlement." *Farinas v. Fla. Farm Bureau Gen. Ins. Co.*, 850 So. 2d 555, 561 (Fla. 4th DCA 2003). The insurer has the obligation to attempt in good faith to defend and resolve the multiple claims in a way that minimizes the policyholder's exposure to judgments in excess of the policy limits.

It should be noted that *Farinas* involved a situation in which multiple claims arose from a single accident. However, insureds may argue that *Farinas* should be extended to apply to multiple, high-exposure claim situations covered under the same policy. The *Farinas* holding mandates that insurers approach multiple claims in the same policy period with special care.

Additional Issues and Risk Mitigation Strategies

The coronavirus pandemic implicates additional issues and potential risk mitigation strategies that warrant further consideration and analysis. For example, consider the following situations:

1. Many states require an insurer to advise the insured of changes in coverage when renewing a policy. When the insurer fails to give appropriate notice, the earlier coverage applies. Therefore, for insurers that add exclusions for claims arising from pandemics in renewed policies, the insurer must be careful to notify the insured of all changes.

2. The coronavirus will result in increased bankruptcies, especially with corporations that lack access to capital. Given that D&O claims are often brought by creditors and/or trustees in bankruptcy, policy provisions must be carefully reviewed.

3. Insurers should consider whether there are proactive, economically feasible strategies that an insurer may take to decrease the likelihood that D&O claims will be brought against its insureds (similar to how homeowner insurers sometimes voluntarily apply fire repellent to insureds' homes during large-scale forest fires). For example, insurers may want to consider providing advice or training to educate corporations and their directors and officers regarding their fiduciary duties.

Conclusion

The perils of the pandemic cannot be avoided by D&O insurers. The economic consequences of the coronavirus are pervasive and businesses will explore every potential source of recovery, including D&O coverage that would not typically be implicated. The lawsuits have already commenced, e.g., a pharmaceutical company has been sued because it allegedly made false statements about its development of a vaccine, thus causing a spike in the value of its stock that crashed after the truth became known. Another action has been filed against a cruise line alleging that it made false statements about the coronavirus to influence the purchase of cruises. The Securities and Exchange Commission has filed an action for injunctive relief and civil penalties against a corporation that issued false press releases about its ability to provide N95 masks.

Given the inclusive language of D&O insuring clauses, the interpretation of policy definitions and exclusions will likely become the focus of litigation. D&O insurers must vigilantly follow decisions rendered by various jurisdictions and develop persuasive approaches to confine D&O coverage to its intended purposes.

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