March 31, 2020

Update: Mitigating Securities Litigation Risks Related to
the Coronavirus

This memorandum updates our alert, “Mitigating Securities Litigation Risks Related to the Coronavirus,” issued March 5, 2020, taking into account recent developments. It also outlines steps companies can take to mitigate the risks associated with COVID-19 shareholder litigation.

The spread of the coronavirus (COVID-19) has significantly impacted the global economy and businesses’ ability to manufacture, distribute and market their products and services, as well as caused the most severe U.S. stock market decline since the 2008 recession, with equity markets down nearly 30% since February. That stock market decline undoubtedly will precipitate stock drop litigation. As recent trends in event-driven litigation demonstrate, the plaintiffs’ securities bar is likely to attempt to craft theories for converting these (and potential future) drops into shareholder derivative claims and class-wide fraud claims.

Potential Risks of Shareholder Derivative Lawsuits

As we explained in the March 5 Memorandum, we expect the plaintiffs’ bar to file derivative lawsuits following COVID-19-related stock drops, asserting that a company’s board ignored warnings that the COVID-19 pandemic would adversely impact business operations and results, and/or took insufficient steps to mitigate the risk. For example, a company that turns out to have insufficient liquidity may face hindsight accusations that its directors failed to take reasonable steps to increase liquidity and conserve resources, such as drawing down revolving credit facilities or canceling a company’s stock buy-back program or reducing its dividend payments.

Since derivative lawsuits frequently are dismissed based on the board’s exercise of business judgment, boards should carefully document their consideration of, and response to, the impact of COVID-19 on their businesses, and consider establishing a public record of their diligence. Certain steps companies may consider taking include:

* Potentially forming a COVID-19 pandemic board subcommittee to handle rapid-response decision making;
* Ensuring that the audit committee is working closely with the auditors to ensure that financial reporting, auditing and review processes are as robust as possible;
* Ensuring that the disclosure committee is still able to perform its functions in respect of public disclosure and is in close contact with risk management and business continuity teams;
* Developing contingency plans in the event senior management becomes ill or incapacitated (which may also trigger disclosure requirements);
* Instituting additional safeguards regarding internal controls in light of the implementation of business continuity contingency plans and reduced access to company premises;
* Developing strategies to increase liquidity and stress testing different disaster scenarios; and
* Reviewing and, if appropriate, reinforcing cybersecurity protections, particularly for companies that have moved to a remote-access model. Our full memo on Mitigating Cybersecurity Risks Related to the Coronavirus can be found [here](https://www.paulweiss.com/practices/litigation/cybersecurity-data-protection/publications/mitigating-cybersecurity-risks-related-to-the-coronavirus?id=30795).
1. Numerous boards are also considering whether to suspend or reduce stock repurchases and/or dividend payments for the next year or more. Although any such decision should certainly take into account any prior statements made about the company’s confidence in its ability to pay the dividend or about its commitment to maintaining its dividend, ultimately the board should do what is prudent for the business. Companies need to maintain financial integrity in these times of crisis: if paying the regular dividend is expected to weaken the company’s financial position, then that fact should be carefully considered in determining whether to change policy regarding dividend payments. Unless a company has made unequivocal statements regarding maintaining dividend payments, akin to a guarantee, it may well be that the securities litigation risk of a claim that the company promised to maintain the dividend will be relatively low.
2. Ultimately, determining what, if any, actions are appropriate should be made individually by each company based on its unique circumstances, in consultation with counsel.

Mounting Risks of Shareholder Stock-Drop Cases

In addition to derivative lawsuits, we also expect a wave of private securities fraud litigation and SEC enforcement actions related to the business and market impacts of COVID-19. In fact, two putative securities fraud class action lawsuits were filed on March 12, 2020, based on COVID-19-related stock drops involving a pharmaceutical company[[1]](#footnote-1) and a cruise line.[[2]](#footnote-2) A third securities fraud class action lawsuit, accusing a U.S. Senator of selling stock based on material nonpublic information about the potential impact of the COVID-19 pandemic, was filed by alleged contemporaneous traders on March 23, 2020.[[3]](#footnote-3)

As companies are grappling with the business consequences of COVID-19, we expect that plaintiffs’ counsel will be carefully scrutinizing quarterly earnings announcements—including the upcoming announcements for the first quarter of calendar year 2020. Since many companies will already have spoken publicly about the effects of COVID-19 on their business operations and earnings, plaintiffs likely will focus on whether new, and previously undisclosed consequences of the pandemic, are emerging in connection with disappointing financial results. In particular, we expect the plaintiffs’ bar to dissect companies’ COVID-19 messaging and disclosures. Companies accused of giving false hope, providing unduly rosy guidance, failing to identify areas of weakness or generally understating the impact of the pandemic, may face securities stock-drop lawsuits following disappointing quarterly earnings announcements.

As we stated in the March 5 Memorandum, public companies should continue to consider whether they have provided an appropriate level of transparency in their public disclosures into the expected impact of the pandemic on operations. Companies should consider whether their risk disclosures need to be updated to augment risks related to the COVID-19 pandemic. Also, companies should consider whether their prior forward-looking guidance has been overtaken by subsequent events and should be withdrawn or updated, as nearly 200 public companies have already done. Note that the decision to provide, withdraw or revise guidance must be made individually by each company based on its unique circumstances. Public companies should evaluate whether they are currently in a position to produce reliable guidance given market conditions and the degree of uncertainty surrounding the economic and other impacts of COVID-19. Additionally, public companies should consider the implications of disclosing revisions to previously issued guidance on their future public disclosure obligations; if a public company issues revised guidance, plaintiffs’ firms may later argue that the company has assumed a duty to provide further revisions as a result of changing circumstances relating to COVID-19 or otherwise. Our full memo on Withdrawing or Revising Earning Guidance can be found [here](https://www.paulweiss.com/practices/transactional/capital-markets-securities/publications/covid-19-withdrawing-or-revising-earnings-guidance?id=31255).

We similarly expect the plaintiffs’ bar and the SEC to focus on companies whose executives and directors purchase or sell stock during the crisis. In the context of private securities litigation, such insider sales can be used by plaintiffs to demonstrate scienter, or fraudulent intent, on behalf of a company executive, by showing that corporate insiders knew that a company’s stock was overvalued in advance of a negative announcement, or undervalued in advance of a positive breakthrough, for example. Separately, insider stock sales can constitute unlawful insider trading, which is independently actionable conduct under the federal securities laws. Notably, the SEC Division of Enforcement Co-Directors issued a statement on March 23, 2020, observing that, amid the current crisis, a greater number of people than usual may have access to material nonpublic information, and cautioning such people “to keep this information confidential and to comply with the prohibitions on illegal securities trading.” Depending on the circumstances, companies should consider whether it might be appropriate to temporarily prohibit stock purchases or sales by corporate officers and directors. Companies are also advised to revisit and closely adhere to corporate controls and procedures around the use and confidentiality of material nonpublic information, including insider trading policies, codes of ethics and Regulation FD. Our full memo on Insider Trading and Selective Disclosure Risks Related to COVID-19 can be found [here](https://www.paulweiss.com/practices/litigation/white-collar-regulatory-defense/publications/sec-enforcement-co-directors-issue-statement-on-potential-insider-trading-and-selective-disclosure-risks-related-to-covid-19?id=31424).

We will continue to closely monitor the legal and business implications associated with the COVID-19 pandemic and report on further developments.

\* \* \*

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

|  |  |  |
| --- | --- | --- |
| 1. Mark S. Bergman+44-20-7367-1601mbergman@paulweiss.com
 | 1. Susanna M. Buergel+1-212-373-3553sbuergel@paulweiss.com
 | 1. Andrew J. Ehrlich+1-212-373-3166aehrlich@paulweiss.com
 |
| 1. Brad S. Karp+1-212-373-3316bkarp@paulweiss.com
2. Audra J. Soloway+1-212-373-3289asoloway@paulweiss.com
 | 1. Daniel J. Kramer+1-212-373-3020dkramer@paulweiss.com
 | 1. Richard A. Rosen+1-212-373-3305rrosen@paulweiss.com
 |
|  |  |  |

*Associate Daniel S. Sinnreich contributed to this Client Memorandum.*

1. *See* <https://www.dandodiary.com/2020/03/articles/securities-litigation/pharma-company-hit-with-securities-suit-over-covid-19-vaccine-claims/>. [↑](#footnote-ref-1)
2. *See* <https://www.dandodiary.com/2020/03/articles/securities-litigation/cruise-line-shareholder-files-first-coronavirus-related-securities-suit/>. [↑](#footnote-ref-2)
3. *See* <https://www.law360.com/articles/1256500/sen-richard-burr-sued-over-covid-19-stock-sale-scandal>. For more information about the STOCK Act and the application of insider trading prohibitions to public officials, see Richard Rosen and Udi Grofman’s article, *Political Intelligence and U.S. Insider Trading Regulations*, published in Securities Regulation & Law Report and available [here](https://www.paulweiss.com/media/3104166/bna_insider_trading_article.pdf). [↑](#footnote-ref-3)