



The Legal 500 Country Comparative Guides Hot Topic

**Directors' and Officers' Liability
in Times of a Global Pandemic
Crisis - Do Desperate Times Really
Call for Desperate Measures?**

Contributing Firm



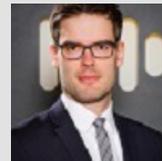
Vavrovsky Heine Marth
Rechtsanwälte

Authors



Philipp Strasser
Partner

philipp.strasser@vhm-law.at



Jan Philipp Meyer
Attorney at Law

Jan.Meyer@vhm-law.at

Directors' and Officers' Liability in Times of a Global Pandemic Crisis - Do Desperate Times Really Call for Desperate Measures?

In December 2019, a new form of pneumonia was discovered in Hubei province, China. The virus responsible for this condition, SARS-CoV-2 ("COVID-19"), spread rapidly and the epidemic's epicentre was, for a long time, situated in Hubei's capital Wuhan. In China alone, the virus infected some 80,000 people and killed more than 3,000 between December 2019 and mid-March 2020. The Chinese authorities have since been able to regain some level of control over the situation after having introduced a variety of harsh measures in order to limit the spread of the pathogen.

At first, most governments in the rest of the world regarded the novel COVID-19 as an awful but local, primarily Chinese phenomenon, thus taking little or no precautionary measures themselves. However, the virus - arguably amplified by international travel - soon spread to other parts of the world. Until recently and despite this fact, some decisionmakers did not take serious what has now turned into a global problem. In only three months, the pandemic has infected more than 300,000 people worldwide and killed some 14,500. Due to COVID-19's exponential infection rate, these numbers may well grow considerably during the next weeks or even months.

Currently the pandemic's epicentre is situated in northern Italy and the numbers of patients throughout Europe (and other parts of the world) continues to grow. As a result, many European countries have implemented shut-down regimes of some form, with some closing borders and airports and urging or even dictating quarantine for most of the population.

Due to the omnipresent media coverage, not only the facts summarised above are all common knowledge today. There is also a general awareness that COVID-19 does not only entail severe medical challenges and inevitably a higher number of deaths but also has tremendous economic impact.

Coping with the Crisis

By and large, the economic effects of this crisis will have to be dealt with by the effected counties on a government level. Aside from this, these extraordinary circumstances also require active and carefully considered crisis management in businesses of every size. After all, even where the crisis does not endanger the existence of individual companies, it is likely to have devastating repercussions on its revenue. At any rate, state aid now promised by some governments will (if and when payed out) most likely not counterbalance the situation's adverse effects in its entirety.

This increases the pressure faced by management, especially from shareholders or third parties. Just as governments and authorities have adopted different approaches to address the challenges at hand, directors and officers throughout the world will take different

approaches of action (and inaction) depending, inter alia, on the individual level of

preparedness and risk management systems in place.

This article takes an Austrian perspective on possible scenarios for directors' and officers' liability in this regard.

Avoiding Liability - Adequate Risk Management

Every executive, at least as far as the Austrian market is concerned, is obliged to see to the establishment of an effective risk management system and, in any way seen fit, intervene appropriately where such system identifies considerable risks (cf "The Duty to Insure in Times of Uncertainty - Risk Management and D&O Insurance under the Business Judgement Rule").

Directors and officers which have relied on a functioning internal control or risk management system before the outbreak and can continue to do so, will have a good chance of avoiding many liability risks such as those pointed out below. This is because they can quickly identify parts of their business that are particularly exposed and can rely on data or experience as to the possible reciprocal effects of certain measures to be implemented.

Where the basic task of risk assessment and management, on the other hand, have been disregarded, directors and officers will often have little chance to "flying-blind" (which is bad enough even without the added crisis situation).

Liability Risks for the Executive Management

On the other hand, there seems to be a near endless list of scenarios - directly or indirectly related to the effects of the COVID-19 pandemic - in which management can breach the duties it owes to the company. The following, non-exhaustive list of actions or inactions could potentially result in losses and give rise to claims against a company's management:

- a) Not having adequate risk control and management systems in place - including a failure to develop or have in place adequate contingency plans (e.g. providing for safe remote access capabilities to the company's IT systems so as to enable staff to work from home).
- b) Failing to properly assess the direct and indirect risks of COVID-19 posed to the company's business / financial performance and implementing measures aiming at minimizing these effects (e.g. allowing for alternative supply arrangements, adapting the products or services offered to the new market conditions). This includes failure to assess all relevant contractual relationships and identifying, on a case-by-case basis, how the respective force majeure clauses are drafted or whether the performance obligation is excluded or suspended under general civil law rules.
- c) Not implementing sufficient safety and health precautions in order to prevent the virus from spreading - this could lead to both unnecessary infections (and, consequently, even deaths) of employees and customers as well as to the official closing-down of the premises by the health authorities (business interruption).

d) Failing to observe protocols recommended by governmental authorities.

e) Failing to apply for state aid in due form and time (e.g. where funding is limited on a first come first serve-basis).

f) Wrongful dismissal of employees, especially when there is no need to permanently reduce headcount, e.g. due to short-term work arrangements (such as the regime put in place by the Austrian legislator in order to prevent mass dismissals of employees). Wrongful dismissals can (i) result in unnecessary legal costs in future employment law proceedings and also (ii) have the effect that the company lacks sufficient staff or key personnel in the future, when these employees are needed to overcome the economic setbacks sustained during the crisis.

g) Not seeking legal advice before making critical decisions such as ceasing to pay rent, open claims, salaries, loan liabilities, stopping production processes.

h) Disregarding the general regulatory framework and mandatory law, such as data protection law (food for thought: currently – especially in the SME sector – millions of private and company laptop computers and inadequately equipped server infrastructure are used to enable staff to work from home. Are the requirements set forth by Article 32 of the General Data Protection Regulation (EU) 2016/679 fulfilled?).

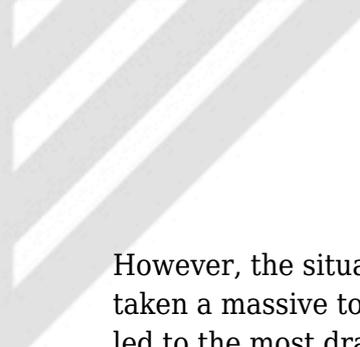
i) Failing to file for insolvency in due time (in Austria, the maximum timeframe to file for insolvency is extended from 60 to 120 days in certain cases of force majeure – COVID-19 was recently added as such case by the legislator). The COVID-19 pandemic has already played a central role in some insolvencies such as that of the British airline Flybe Group PLC.

j) Failing to inform shareholders adequately (including necessary ad-hoc announcements).

The level of scrutiny will depend both on the shareholder structure as well as the company's general risk exposure. Generally, the risk exposure will be higher for (i) companies with extensive operations in significantly affected regions and countries, (ii) companies with vulnerable global supply chains and (iii) business sectors which are highly affected by current restrictions such as restaurants, hotels, airlines and most non-online trade.

Will COVID-19 affect Directors' and Officers' Liability Insurance ("D&O") Policies?

At first glance, D&O policies do not seem to be particularly exposed – at least as the pandemic's direct effects are concerned. The typical claims covered under such policies are not connected to global phenomena (such as pandemic virus outbreaks) but rather specific cases of mismanagement and breaches of duty on parts of a company's management. Also, virus outbreaks in the past (Ebola, MERS, SARS-CoV) have triggered relatively little claims in this regard – certainly as far as the European market is concerned. That comes as no surprise, because these other virus outbreaks were limited to certain regions of the world with little direct effect on European territory.



However, the situation could well be different for COVID-19. The current pandemic has already taken a massive toll on stock indices worldwide and arguably, from a European perspective, led to the most drastic non-military situation of crisis after World War II. This has created an economic situation in which sensible and swift but well-considered management decisions are crucial for a company's survival and its prevailing against competitors.

In such an irritated and hectic market environment, desperate courses of action can be expected to some degree. It goes without saying that the risk of breaches of duty on the part of a company's management grows in times of crisis. Thus, when a large number of entities are facing critical situations at the same time (e.g. due to the COVID-19 pandemic's direct or indirect effects), a rise in liability claims vis-à-vis management can be expected. In fact, several COVID-19-related claims have already been notified under D&O policies on the European market. One publicly known example is a securities claim filed against Norwegian Cruise Line Holdings, Ltd. alleging that company made false and misleading statements about the impact of COVID-19. Internal documents leaked to the media prove that the sales team was instructed to mislead and lie to potential customers in order to encourage them to book cruises.

It remains to be seen how this situation develops. Regardless of the number of claims, the assessment of both liability and coverage-related issues of each individual claim will have to be examined on a on a case-by-case basis. It is well possible - probably even likely - that most claims notified under D&O policies will not actually be justified (and lead to insurance payouts).

As far as the liability tier is concerned, particular attention will have to be paid to the adherence of the principles of the Business Judgement Rule (acting with the care of a prudent businessman - especially on an informed basis, in good faith, and in the honest belief that the decision taken was in the company's best interest). This will, inter alia, require an in-depth assessment of the company's economic situation before the crisis, its crisis management as well as the (documented) motives that led to the taken decision in question. The same holds true for issues related to insurance coverage which may, at least in some constellations, be tricky to solve. Even though many claims may ultimately be meritless, the efforts and costs relating to their defence may well be significant, especially due to the novelty and unpredictability of circumstances.