

Practice Update

COVID-19: Navigating the Heightened Risk of Securities Litigation

March 16, 2020

Public companies are facing their newest and potentially inevitable challenge: the risk of securities litigation over the impact of the coronavirus (COVID-19).

The recent market volatility driven by the viral outbreak – including the largest decline since 2008 – is a recipe for class action “event-driven” lawsuits frequently premised on stock drops. The prospective impact on businesses is unprecedented and uncertain.

The U.S. Securities and Exchange Commission (SEC) is actively monitoring these events and, on March 4, 2020, issued a [press release](#) “remind[ing] all companies to provide investors with insight regarding the assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments.” Indeed, the SEC expressly noted that “[h]ow companies plan and respond to the events as they unfold can be material to an investment decision...”

The SEC is not the only one monitoring developments. The securities class action plaintiffs’ bar is actively soliciting plaintiffs for potential class action lawsuits relating to the coronavirus. Generally, we anticipate that such cases will focus

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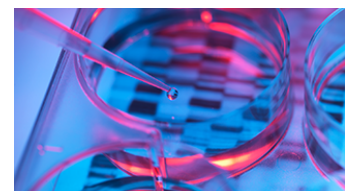
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on alleged inadequate risk disclosures, purported violations of company codes of conduct and compliance guides in managing the fallout from the coronavirus impact, and potentially negative press coverage relating to business operations. A prime current example is the cruise line industry. After their businesses have been decimated by the coronavirus, cruise lines are now facing allegations of wrongdoing premised on actions purportedly taken, and statements purportedly made, regarding safety. We suspect that the cruise industry could be the canary in the coal mine, with widespread litigation affecting businesses across the spectrum.

The plaintiffs' bar will likely argue that even if companies could not predict the specific risks associated with the coronavirus, they should have at least warned of the general risks associated with a viral pandemic, with the attendant impacts to consumers, supply chains and the like. And, as the impact from the coronavirus develops and evolves, companies may be at risk for litigation for failing to appropriately address those risks.

In addition to securities fraud claims under Section 10(b) and 20(a) of the Securities Exchange Act of 1934, companies issuing securities in the future could face claims under Sections 11 and 12(a)(2) of the Securities Act of 1933, which do not require a showing of fraudulent intent. Finally, companies should be aware that Regulation S-K may be invoked by plaintiffs to support their misstatement and omission claims. Specifically, they may rely on Item 303 of Regulation S-K, which requires disclosure in the management discussion and analysis section of "any known trends or uncertainties... that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." The federal circuits are split on whether an alleged violation of this regulation gives rise to a securities fraud claim, but that has not deterred the plaintiffs' bar from advancing this position.

Companies can mitigate their exposure by updating their risk disclosures, including reevaluating their cautionary language to invoke the forward-looking protections of the Private Securities Litigation Reform Act's safe harbor. As events develop, particularly in the next few weeks, companies should seek to provide timely and adequate transparency into the potential effects of the coronavirus on their business.

In addition to securities fraud claims, those that sit on a public company's board of directors may be faced with derivative litigation predicated on an alleged oversight failure, such as a purported failure to act in accordance with the company's code of conduct or a failure to appropriately respond to red flags.

It is impossible to predict the effects of this pandemic which is constantly evolving. It is prudent to take precautionary steps to mitigate the risk associated with coronavirus, and the as-of-yet undetermined scope of the potential resulting damages.

Akerman's Securities Litigation Practice will continue to follow COVID-19 developments and advise on occurrences that may impact corporate interests.

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