2019 Year In Review

News and Developments in Executive Liability and Insurance

Volume 16

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From the Editors

Aon's Financial Services Group is pleased to present our annual Year in Review, now in its sixteenth edition. The contents include summaries of the cases relating to management liability, professional liability, and cyber policies, as well as decisions relating to corporate governance and securities laws.

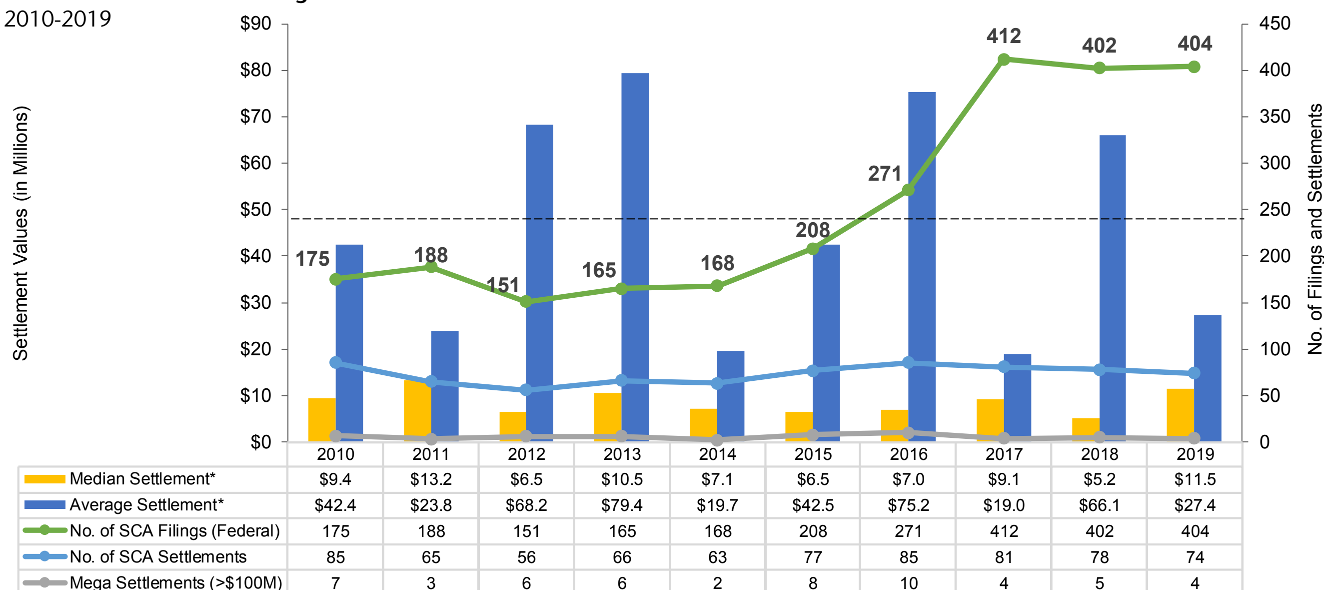
2019 was, again, a year that saw near-record filings, at the levels seen in 2017 and 2018. The chart below depicts the number of filings since 2010 and the median and average settlement amounts. In 2019, while the number of settlements remained somewhat constant, the average was significantly lower than in 2018, but the median was at its highest level of the ten-year period.

In 2019 we observed developments in corporate governance law, including important decisions from Delaware relating to the *Caremark* standard, which dictates how a plaintiff must plead and prove that a corporate director or officer acted in bad faith and in breach of the duty of loyalty. Additionally, various courts dealt with the procedural considerations that arose after the United States Supreme Court's ruling in *Cyan* in 2018, including stays of discovery pursuant to the PSLRA and consolidation and remand of existing securities litigation.

In the 2019 Year in Review, we also address the continuing interpretation of management liability policy provisions. There are important and interesting decisions relating to the definition

Securities Class Actions Filings v. Securities Class Action Settlements

2010-2019



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Median Settlement*	$9.4	$13.2	$6.5	$10.5	$7.1	$6.5	$7.0	$9.1	$5.2	$11.5
Average Settlement*	$42.4	$23.8	$68.2	$79.4	$19.7	$42.5	$75.2	$19.0	$66.1	$27.4
No. of SCA Filings (Federal)	175	188	151	165	168	208	271	412	402	404
No. of SCA Settlements	85	65	56	66	63	77	85	81	78	74
Mega Settlements (>$100M)	7	3	6	6	2	8	10	4	5	4

- - - - 2010 - 2018 SCA Filing Avg. (238)
**Settlement dollars are adjusted for inflation; 2019 dollar equivalent figures are used.*
Filing Data – Stanford Law School Securities Class Action Clearinghouse;
Settlement Data – Cornerstone Research – Securities Class Action Settlements (2019 Review and Analysis)

of Claim and what constitutes a related or interrelated claim, and whether a prior act or a specific matter exclusion might then be applicable. Other decisions address the continuing issues that arise in social engineering fraud matters, and interpretation of notice provisions under the policies.

In 2019 we saw a number of decisions involving the Illinois Biometric Information Privacy Act, or "BIPA", which are likely to set the stage for further privacy-related matters in the future. We also highlight developments in cyber and privacy liability, including some significant regulatory settlements and developments.

We hope you enjoy the 2019 Year in Review and find this compilation useful. We look forward to advising on trends and developments throughout 2020. Thank you, as always, for your interest and support.

Best Regards,

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News & Developments

First Quarter

Cyberattack on SEC: From Levier of Fines to Victim

The Securities and Exchange Commission ("SEC") recently commenced a civil action against individuals in Ukraine, California, Russia, and Korea as well as two businesses in Hong Kong and Belize, arising from an alleged fraudulent scheme to hack into the SEC's online Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system ("SEC Action"). The scheme sought to obtain nonpublic documents containing earnings announcements of publicly-traded companies, and to then use that information to profit by trading in advance of the information becoming public. Similarly, the U.S. Attorney's Office for the District of New Jersey announced a parallel indictment against two of the Ukrainian hackers.

The SEC Action alleges that an individual defendant, Oleksandr Ieremenko, ("Individual Defendant") used a variety of deceptive means to obtain thousands of nonpublic "test filings" from the SEC's EDGAR system's servers. This hacked material nonpublic information was then transmitted to traders who, in connection with approximately one hundred fifty-seven earnings announcements, used it to place profitable securities trades before the information was made public. More specifically, the remaining individual and entity defendants served as part of a network of securities traders located in the United States, Ukraine, and Russia, who received the hacked information from the Individual Defendant. The defendants, using such illicit information, reaped over $4 million in gross gains from trading on such nonpublic EDGAR filings.

The SEC Action seeks relief under Section 20(b) of the Securities Act of 1933, and Sections 21 and 21A of the Securities Exchange Act of 1934 to enjoin the transactions, acts, practices, and courses of business alleged in this Complaint and to seek orders of disgorgement, along with prejudgment interest, and civil penalties. The SEC Action asserts that the illicit gains by the defendants were in addition to gains generated during an earlier phase of the scheme in which the Individual Defendant and others hacked material nonpublic information from at least three newswire services.

In Rare Securities Class Action Trial, California Jury Reaches Verdict

A jury in the Central District of California recently reached a verdict in a securities class action lawsuit that was brought against a company and several of its directors and officers. The company was a biopharmaceutical company that developed cancer-fighting drugs and the case involved certain alleged misrepresentations and omissions concerning the use, testing and efficacy of one of its drugs.

In the securities suit, the plaintiffs alleged that the misinformation involving the efficacy of the drug had a significant impact on the price of the company's stock and upon the release of the information concerning the results of the drug trials, the stock price declined substantially.

The jury verdict form asked the jury to reach a decision on four alleged misstatements in the company's announcement of alleged positive results involving a Phase III clinical trial of one of its cancer drugs. Ultimately, the jury found that the plaintiffs had only proved that one of the four alleged misstatements was truly "false and misleading." The jury further found that the amount of damages per share of company stock caused by the single misleading statement was $4.50 per share. The amount of actual damages will be the subject of further computations based partially upon this amount per share, the number of shares traded during the class period with adjustments and the results of any post-trial motion practice.

Interestingly, the announcements from the plaintiffs' law firm (Robbins Geller Rudman & Dowd, LLP) subsequent to the verdict characterizes the award to shareholders of "up to $100 million in damages" while the announcement from the company reported a litigation victory, with the verdict representing 5% or less of the claimed damages. The company's CEO stated that "we are extremely pleased with the jury verdict… [a]nd [] excited to return our focus to running the business." *Hsingching Hsu v. Puma Biotechnology, Inc. et al.*, No. 15-0865, ECF 718 (C.D. Cal. Feb. 4, 2019).

Cornerstone Research Reported Securities Class Action Filings Near Record Levels in 2018

A new report by Cornerstone Research, entitled "Securities Class Action Filings — 2018 Year in Review," highlighted that 403 federal securities class actions were filed in 2018 compared to 412 filed in 2017. Despite the slight decrease from 2017 to 2018, this 2018 figure was double the number of average filings between 1997-2017 — with the average number of filings over this period totaling 203.

State court securities filings drove the activity to even higher levels. Following the United States Supreme Court decision in *Cyan Inc. v. Beaver County Employees Retirement Fund*, 2018 also saw securities class action litigation filed in state court. Accounting for state court activity, 2018 arguably represented the most significant year of filing activity yet since the end of the dot.com era. In fact, when counting the 17 stand-alone state court securities class action lawsuits filed in 2018, the 420 securities class action lawsuits filed in 2018 exceeds the 2017 total.

The Cornerstone Research report also noted:

- In 2018, 4.5% of US exchange-listed companies were the subject of securities filings. Core securities filings (all federal securities class action filings excluding those defined as M&A filings) against S&P 500 firms in 2018 occurred at a rate of 9.4%, the highest percentage since 2002.
- Core filings against Technology and Communications companies combined were up 56%.
- The second (71) and ninth circuits (69) saw the most filings while core filings decreased in the third and seventh circuits.
- Filings involving M&A transaction allegations including Section 14 claims, but no Rule 10b-5, Section 11, or Section 12(2) claims, decreased to 182 from 198 in 2017. M&A filings also had a higher rate of dismissal (86%) than other core filings (47%) from 2009-2017.
- In 2018, individuals, as opposed to institutional investors, were appointed lead plaintiffs more often.

Continues

- The MDL Index (Maximum Dollar Loss Index — which is the dollar value change in defendant firm's market capitalization from the trading day with the highest market cap during the class period to the trading day immediately following the end of the class period) reached over $1.3 trillion in 2018, surpassing 2008 to become the third largest year on record. The MDL Index increased 152% relative to 2017. The MDL increase appeared to be driven by mega filings, which increased to 27 from 14 the year before. The stock market decline in the latter part of the year also magnified market value losses over class periods for many filings.

Cornerstone Research Reports Significant Increases in Securities Class Action Settlements in 2018

Cornerstone Research released its review and analysis of Securities Class Action Settlements for 2018. It determined in general that economic factors played an important role in the increase in settlement size in 2018. It also determined that event driven securities litigation may have a greater impact on future settlement trends given that it takes several years to resolve such cases.

Highlights of the report include:

- 78 securities class action settlements approved in 2018, slightly less than 2017.
- More than 14% of the settled cases had an accompanying criminal action.
- Total settlement dollars increased dramatically over 2017's near low to over $5 billion, which was 50 percent higher than the average for the prior nine years.
- There were 5 mega settlements that were equal or greater than $100 million, ranging from $110 million to $3 billion.
- Small settlements (less than $5 million) declined by 40% from 40 cases in 2017 to 25 cases in 2018.
- The average settlement amount more than tripled to $64.9 million over the level in 2017.
- Median "simplified tiered damages" increased 88% from 2017. The median issuer defendant total assets of $829 million was almost 50 percent larger than for 2017 settlements.
- The average time to reach the motion for class certification stage was almost 5 years.
- The proportion of settlements with a public pension plan as lead plaintiff was the lowest level in a decade.
- Accompanying derivative cases reached the highest level in the last decade.
- 2018 had one of the highest rates of corresponding SEC actions among distressed firms in the past decade.
- Average life of a case from filing to settlement in 2018 was 3.3 years.

ISS Amends List of Post-PSLRA 100 Largest Class Action Settlements

In February 2019, Institutional Shareholder Services ("ISS") published a report on 2018 class action trends and updated its list of the 100 largest class action settlements since passage of the Private Securities Litigation Reform Act ("PSLRA") in 1995. The "Top 100" list now includes the following 2018 settlements: 1) Petroleo Brasileiro S.A. (Petrobas) - $3 billion; Wells Fargo & Co. - $480 million; Allergan, Inc. - $250 million; and Wilmington Trust Corp. - $210 million. Petrobas is the largest non-US company to settle in the US court system and the settlement is the fifth highest in the Top 100.

Other noteworthy statistics for 2018 include the following:

- $5.82 billion in settlement funds were approved for distribution.
- The number of settlements dropped year over year from 163 to 126, but settlement dollars were 164% higher.
- 94 of the 126 settlements were federal court cases, with 20 of those being handled in the U.S. District Court for the Southern District of New York, totaling $3.35 billion.
- 13 of the 126 cases were in Delaware Chancery Court (the most frequently utilized state court) and totaled $231.3 million.

Second Quarter

FTC Seeks to Strengthen Privacy and Data Security Protections

The House Energy and Commerce subcommittee on consumer protection held a hearing entitled, "Oversight of the Federal Trade Commission: Strengthening Protections for Americans' Privacy and Data Security." During the hearing, the FTC chairman urged Congress to enact national privacy and data security legislation, enforceable by the FTC, to regulate tech companies' collection and use of consumers' data. The FTC commissioners also asked Congress for more funding and greater authority to impose penalties and police privacy violations.

Currently, the FTC has no authority to levy civil penalties for initial violations for most unfair or deceptive acts or practices. For a first violation, the FTC may generally only obtain injunctive relief and an order prohibiting the challenged conduct. The FTC may only pursue civil penalties for violations of a final order.

Two of the FTC commissioners argued that the FTC should name top executives as liable parties in some cases. One commissioner contended that only significant penalties would deter tech companies' privacy violations.

Advocates of tougher laws and regulations have pointed to several recent security breaches like the Equifax data breach and the Facebook/Cambridge Analytica situation. The FTC recently reported that it has only 40 full-time staff devoted to privacy and data security, while the U.K. Information Commissioners' Office has about 500 employees and the Irish Data Protection Commissioner has about 110 employees, yet the United States' population is exponentially larger. The FTC has said that $50 million of additional funding would allow it to hire 160 new full-time employees, which would allow the agency to substantially improve its monitoring and enforcement capabilities. Although privacy and security investigations often require significant technical expertise, the FTC only has 5 full-time employees classified as technologists.

First Ever Data Breach Class-Action Suit in London Could Expand Liability

The High Court of Justice Queen's Bench Division in London ruled that the Data Protection Act of 1998 ("DPA") allowed an employer to be held vicariously liable for the acts of its employee who intentionally released the protected data of other employees.

Outside auditors gave employee personal data to a member of the employer's staff for processing a task for the audit. That employee had been recently disciplined for an unrelated matter. Sometime after the audit, the employee released the company's employee personal data on the internet. The affected employees filed a class action suit against the employer for violations of the Data Protection Act and common law. The employees alleged that the employer had primary liability for releasing the information and vicarious liability for the employee's act.

The court had to determine liability even though the DPA imposes strict liability rather than qualified liability, because the plaintiffs raised the alternative question of absolute liability in the event the employer was not found to be strictly liable in the case. The court held that in this case primary or strict liability should not be imposed upon the employer as it did not expressly violate any of the principles of the DPA. However, the court disagreed with the defense's notion that the terms of the DPA excluded vicarious liability. The court held that the employer was vicariously liability to the class of employees for the acts of the rogue employee in releasing the data to the web.

SEC Public Enforcement Activity Near Record Levels in First Half of Fiscal 2019

The Securities and Exchange Commission's enforcement activity in the first half of 2019 continued at near-record levels according to a Cornerstone Research and NYU Pollack Center for Law and Business report. The increase was a continuation of a resurgence in enforcement activity that began in the second half of 2018.

The 52 enforcement actions initiated against public companies rank third when reviewing the half year enforcement activity of prior years. The report's authors believe that part of the increase can be attributed to the SEC's Share Class Selection Disclosure Initiative. This initiative was developed to reduce on-going harm in the sale of mutual fund shares by investment advisors. The SEC brought 79 enforcement actions against investment advisors pursuant to this initiative. Of the 79, 25 were filed against public companies and are included in the 52 enforcement actions mentioned above.

Conversely, the monetary settlements from SEC enforcement actions against public companies decreased in the first half of FY2019. The $742 million collected represented a 24% decrease from the half-year average of amounts collected over the prior three years.

The report provides additional detail by industry, venue, and allegation among other categories. *Cornerstone Research—SEC Enforcement Activity: Public Companies and Subsidiaries Midyear FY 2019 Update.*

SEC Multi-Million Dollar Whistleblower Awards Announced

In March, the SEC announced several large whistleblower awards. The SEC issued a press release announcing a $13 million award and a separate $37 million award, which was the third largest award in history. The matter involved an SEC enforcement action against a bank and investment advisory service that allegedly failed to disclose conflicts of interests to its clients. The defendants allegedly did not disclose that they preferred to invest client assets in the firm's own proprietary investment products. The enforcement action resulted in a payment of $267 million and an admission of wrongdoing by the defendants. The individual law firm client/whistleblower was ultimately awarded $13 million for the whistleblowing tip and cooperation with the SEC.

Separately, the Commodity Futures Trading Commission ("CFTC") announced an award in excess of $2 million to a whistleblower in recognition of the whistleblower's cooperation. The award highlighted "two key aspects of [the] Whistleblower Program — that an individual doesn't have to be an insider to receive a whistleblower award and the Commission can pay awards based on related actions brought by other regulators."

Post-*Cyan*: Does the PSLRA's Automatic Stay of Discovery Apply in State Court?

Following the United States Supreme Court's landmark decision in *Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund*, 138 S. Ct. 1061 (2018), which held that state courts have concurrent subject matter jurisdiction over class actions that exclusively allege claims under the Securities Act of 1933 ("Securities Act"), an open question remained as to whether the Private Securities Litigation Reform Act of 1995's (PSLRA) automatic stay of discovery applied during the pendency of a motion to dismiss in state court. Over one year since the *Cyan* decision, the PSLRA's automatic stay provision's applicability remains an open question – as states have come to differing conclusions.

California was one of the first state courts called upon to opine on the issue in *Switzer v. W.R. Hambrecht & Co.*, 2018 Cal. Super. LEXIS 2429 (Cal. Super., 2018). In a rather terse decision denying a request for a discovery stay, the California court, with little explanation, held that the "PSLRA's provision for a discovery stay is of a procedural nature, and therefore only applies to actions filed in federal court, not state court."

However, in *City of Livonia Retiree Health & Disability Benefits Plan v. Pitney Bowes, Inc.*, 2019 Conn. Super. LEXIS 1604 (Conn. Super., 2019), a lawsuit was brought by purchasers of two series of notes offered in connection with an initial public offering. Defendants moved to strike the complaint under Connecticut statute, and moved for an automatic stay of discovery under Section 77z-1(b)(1) (of the PSLRA), arguing that the motion to strike was equivalent to a motion to dismiss under Section 12(b)(6) of the Federal Rules of Civil Procedure, and that, in any event, defendants had good cause for a protective order under Connecticut law. Plaintiff maintained that the PSLRA discovery stay only applied to lawsuits in federal court and that the provision did not apply because a motion to strike is not comparable to a motion to dismiss in federal court. In interpreting whether the PSLRA automatic discovery stay applied in Connecticut state court, the court turned to the plain language of the statute. After comparing multiple provisions of the PSLRA, the court ultimately

Continues

concluded that the discovery stay subsection applies to "actions pending in state court as well as federal court."

Following in California's footsteps, the New York state court in *Matter of PPDAI Group Sec. Litig.,* 2019 N.Y. Misc. LEXIS 3481 (N.Y. Sup. Ct., N.Y. Cnty. 2019), found that the PSLRA's automatic stay of discovery pending the decision on a motion to dismiss a Securities Act claim did not apply. The court concluded that, "(a)application of the federal PSLRA automatic stay would undermine *Cyan's* holding that '33 Act cases may be heard in state courts."

Unfortunately, the lack of uniformity as to the PSLRA's automatic discovery stay will present practical and financial issues for litigants facing claims in state court under the Securities Act. Over time, more jurisdictions may weigh in on this issue, as well as appellate courts, for additional guidance.

Rideshare Company Sued in IPO-Related Securities Class Action

Within days of going public, a rideshare company, its directors and officers, and underwriters were sued by investors alleging securities violations concerning disclosures in its initial public offering documents. The company went public on March 28, 2019 at an initial offering price of $72 per share and the share price declined 17% to $59.51 by April 17th. The investors claim that the registration statements contained misleading statements concerning two distinct disclosures related to different business components. Specifically, the allegations center around the disclosures concerning its ridesharing market share and issues involving its recently acquired bike-share company.

In the initial offering documents, the company represented that its "...ridesharing market share was 39% in December 2018...." and the class plaintiffs allege such was overstated. While the complaint does not have much detail, it notes that the stock price declined due to investors' concerns about the potential overstatement. They also mention that in its own Form S-1 filing, the company's competitor noted that it had a 65% market share thereby calling into question the alleged market share disclosed by the company in its offering documents. Additionally, concerning its bike-share business, the plaintiffs allege that the statements in the offering documents were materially inaccurate or incomplete, because they failed to disclose that "...more than 1,000 of the bicycles in [the company's] rideshare program suffered from safety issues that would lead to their recall..." The complaint cites to two articles in the New York Times and The Wall Street Journal, which reported on safety issues as part of the revelations leading to the reduced stock price. *Hinson et al. v. Lyft, Inc. et al.,* No. CGC-19-575293 (Cal. Super. Ct., San Fran. Cty. April 16, 2019).

Supreme Court to Answer whether the Civil Rights Act Protects Gay and Transgender People from Workplace Discrimination

In April 2019, the United States Supreme Court announced that it would decide the separate questions of whether gay and transgender people are protected from workplace discrimination under the Civil Rights Act of 1964. The Act prohibits "discrimination based on... sex", among other things.

On the topic of sexual orientation discrimination, the Supreme Court agreed to hear two cases with conflicting holdings — a New York case, *Zarda v. Altitude Express, Inc.,* 2018 U.S. App. LEXIS 4608 (2d Cir. 2018). The New York and Georgia cases both involve individuals that were fired because they were gay. In *Zarda*, the U.S. Court of Appeals for the Second Circuit allowed the lawsuit to proceed after concluding that "sexual orientation discrimination is motivated, at least in part, by sex and is thus a subset of sex discrimination". Notably, in *Zarda*, the Department of Justice filed an *amicus* brief noting that it does not equate sexual orientation discrimination with discrimination on the basis of sex. In *Bostock v. Clayton Cty. Bd. of Comm'rs,* 2018 U.S. App. LEXIS 12405 (11th Cir. 2018), the U.S. Court of Appeals for the Eleventh Circuit relied on a 40-year-old decision and ruled that "discharge for homosexuality is not prohibited by Title VII."

With respect to discrimination against transgender individuals, the case before the Court, *EEOC v. R.G. and G.R. Harris Funeral Homes,* 2018 U.S. App. LEXIS 5720 (6th Cir. 2018), involves the firing of a transgender woman. The U.S. Court of Appeals for the Sixth Circuit held that "[d]iscrimination against employees, either because of their failure to conform to sex stereotypes or their transgender and transitioning status, is illegal under Title VII". This ruling was based on the rationale that "[d]iscrimination 'because of sex' inherently includes discrimination against employees because of a change in their sex."

EEOC Annual Filings Figures Show Increase in Sexual Harassment Cases

The Equal Employment Opportunity Commission reported in April of this year that while the overall number of employment cases has declined, sexual harassment charges filed with the agency increased year-over-year by over 13 percent. Many predicted an increase in sexual harassment claims; however, the double-digit increase exceeded most expectations.

The EEOC's annual announcement of enforcement statistics is an opportunity to spotlight trends, including the increases or decreases in certain types of employment claims. In each of the past four years, the number of sexual harassment claims has increased. The current increase, to over 7,600 sexual harassment matters, reflects both the impact of media and accountability in the entertainment industry. Employment law commentators have opined that the #MeToo movement is not a trend or passing fad. Rather, there is sustained and increased attention to the need for appropriate and respectful behavior in the workplace. EEOC Acting Chair Victoria Lipnic stated: "we cannot look back on last year without noting the significant impact of the #MeToo movement in the number of sexual harassment and retaliation charges filed with the agency."

The EEOC also reported a record $56.6 million secured in settlements and awards for victims of sexual harassment. Employers are increasingly viewed as evaluating seriously the increasing exposure for sexual harassment allegations.

Overhauling Workplace Culture in the Federal Judiciary

The federal judiciary was not immune to the stories of sexual harassment and

Continues

inappropriate conduct which became emblematic of the #MeToo movement. A Los Angeles Times article details the downfall of Judge Alex Kozinski, who previously sat on the U.S. Court of Appeals for the Ninth Circuit. (*9th Circuit Judge Alex Kozinski steps down after accusations of sexual misconduct*, December 18, 2017). The article describes Judge Kozinski as one possessing a brilliant legal mind, but whose conduct "had been the subject of whispers for years." In 2008, an investigation was conducted into a server maintained by the judge containing pornographic images when he inadvertently made the images available to the public. However, "it was his alleged treatment of clerks and other women in the legal profession that brought his career careening to a halt" resulting in his abrupt resignation. Judge Kozinski was accused by at least 15 women of "inappropriate behavior, from showing them pornography to improperly touching them."

Around this same time, Jill Langley, director of workplace relations for the U.S. Court of Appeals for the Tenth Circuit, was selected to serve as the federal judiciary's first Judicial Integrity Officer. This office monitors workplace issues and offers training throughout the judiciary. It also serves as a resource for workplace conduct staff. In April, Ms. Langley sat down for an interview with Law360 to discuss the new office which opened in January, how she came to occupy the new position and hopes for the new office. Ms. Langley recounted that each court has an employment dispute resolution process and a coordinator to advise employees of their rights; however, she felt there was a need for more training in employment laws. Upon providing training in the courts throughout the Tenth Circuit, she began to receive requests for training from across the country. She was asked by Lee Ann Bennett, Deputy Director of the Administrative Office, if she might be interested in conducting training nationally, after Chief Justice Roberts formed the workplace conduct working group. Since taking the office she has participated in workplace conduct workings and conferences. She has also interacted with "judges [who] are aware there is this power imbalance and they're asking what they can do to minimize that." When describing her impressions about the nature of the federal court's workplace problems, Ms. Langley reports that "some of the calls I've gotten are about supervisors screaming and yelling, someone who has good days then is screaming the next, a kind of pattern of people reporting anger management issues. It's not just in a performance review kind of way, but people being insulting and denigrating. That's an issue we're taking on head-on. The codes of conduct for both judges and employees now expressly prohibit abusive conduct." In describing in practical terms, how the new office would practically address a stated goal of serving as an information clearinghouse giving the confidential complaints, Ms. Langley responded that "some of these issues do get resolved informally, some requests for help leave paper trails and some don't, and that is one of the conundrums with making more of this kind of information available. I don't use personally identifying information when I'm asked about trends or specific situations." Ms. Langley concluded that "every time I begin to see where we could do be doing things better, I'll advocate for doing things better."

Third Quarter

First Half of 2019 Securities Filings on Record Pace

Cornerstone Research and Stanford Law School Securities Class Action Clearinghouse released its 2019 midyear report which provides statistics on securities fraud filings. In the first half of 2019, plaintiffs filed 198 new federal class actions. This includes 126 core filings (excluding mergers & acquisitions actions) which missed the 2017 record by one. Core filings rose from 108 to 126 largely due to market volatility in the second half of 2018. Consumer non-cyclical industries such as biotechnology, pharmaceutical and healthcare were most affected, as were internet and high-tech firms. M&A claims, which are not included in the core filings, declined more than 20% since the second half of 2018.

Another continuing trend was the shift in cases from federal court to state court due to the impact of *Cyan.* Post *Cyan,* there have been 61 new 1933 Act filings: 23 parallel filings, 12 filings in federal courts only, and 26 filings in state court only.

The SEC also initiated 52 enforcement actions against public companies, arising out of the Share Class Initiative. The Share Class initiative is designed to "identify and remedy" situations where investment advisors fail to make required disclosures. Of the 52 actions filed, 25 were filed against 27 public companies and subsidiaries. The average monetary settlement in the Share Class Initiative program was $3 million. This amount is lower than the $15 million per action average for the first half of the 2019 fiscal year, in part because the SEC determined to not impose monetary penalties on eligible advisors as part of the program. Settlements under the program totaled $75 million. Settlements in SEC actions for all types of defendants in public company and subsidiary actions totaled $745 million for the first half of 2019.

Details on this and other enforcement actions can be found in the Cornerstone Research SEC Enforcement Activity: Public Companies and Subsidiaries Midyear FY 2019 Update.

Fourth Quarter

A Second Delaware Case Finds Potential *Caremark* Liability

Prior to 2019, potential liability under the Caremark standard in Delaware derivative litigation was rare, as it was viewed as one of the most difficult theories of corporate liability on which to prevail. To establish liability, moving plaintiffs are required to plead and prove that directors acted in bad faith such that it can be proven that directors knew that they were breaching the duty of loyalty, as set forth in *In re Caremark Int'l Inc. Deriv. Litig.,* 1996 Del. Ch. LEXIS 125 (Del. Ch. 1996). Stated differently, boards are presumed to have acted in good faith and in their companies' best interests. Compelling evidence of more than mere negligence or poor governance, including evidence of board members' failure to act or actual knowledge of their fiduciary breach, is required to overcome that presumption.

In a trend developing this year, the Delaware Supreme Court has found liability established under the *Caremark* standard. In June, the court reversed a Delaware Court of Chancery

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dismissal of a *Caremark* claim involving Blue Bell Creameries. The Chancery Court held that the plaintiffs had sufficiently alleged facts regarding the defendants' failure to conduct adequate oversight of food safety, which was a critical issue given the nature of Blue Bell Creameries' ice cream product. *Marchand v. Barnhill,* 2019 Del. LEXIS 310 (Del. 2019).

On October 1, the Chancery Court weighed in on another *Caremark* case, denying a motion to dismiss in *In re Clovis Oncology, Inc. Derivative Litigation.* Citing the June 2019 *Marchand* decision, the court highlighted the importance of board oversight of compliance with legal and regulatory requirements, particularly for companies that have a single product on offer. Here, the pharmaceutical company had no sales revenue and was relying on the future success of its only promising drug, a cancer treatment. The board had received conflicting reports about its success but the company consistently reported positive and unverified results. After the Federal Drug Administration identified discrepancies in the drug trial results, the company reported them, resulting in a share price drop, securities litigation, and regulatory penalties. The court concluded that the board, composed of doctors and other knowledgeable professionals, failed to exercise meaningful oversight, such as in refusing to investigate conflicting trial results. *In re Clovis Oncology, Inc. Derivative Litig.,* 2019 Del. Ch. LEXIS 1293 (Del. Ch. 2019).

Cyan Continues to Wreak Havoc: Compels Remand of Previously Removed State Court Securities Suits

The procedural havoc that *Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund,* 138 S. Ct. 1061 (2018) caused continues to be on display.

In November 2015, two investors of redeemable preferred stock (of Miller Energy Company ("Miller") which subsequently filed for bankruptcy after the stock offering) filed separate actions under the Securities Act of 1933 in Tennessee state court against Miller's directors and officers, as well as the underwriters of the stock offering. Shortly after the filing of the two complaints, the defendants removed the actions to federal court. The plaintiffs responded procedurally by filing motions to remand the actions back to state court. The federal court denied the motions to remand and also granted the defendants' motion to consolidate the two actions, together with a third action that had been filed in federal court in the first instance.

After the three actions were consolidated and federal court found to be the proper venue, the plaintiffs filed an amended consolidated complaint.

The defendants responded by filing a motion to dismiss, which was granted in part and denied in part. In June 2018, following the March 2018 decision in *Cyan*, the plaintiffs filed a renewed motion to remand the cases to state court.

On December 6, 2019, Judge Varlan granted the plaintiffs' motion to remand to state court, the two originally filed state court actions (but declined to remove the third action, which was originally filed in federal court). The court reasoned that the United States Supreme Court's *Cyan* decision, entered subsequent to its prior ruling which had previously denied the plaintiffs' motion to remand, represented the kind of "extraordinary circumstances justifying reconsideration of the Court's prior holding, namely a 'subsequent contrary view of the law by the controlling authority.'" The court also ruled that the plaintiffs, by engaging in limited litigation activity in the consolidated federal court action, had not waived their right to object to improper removal.

This decision underscores the procedural complexity *Cyan* has caused. Here, from a situation in which three pending actions were consolidated for procedural purposes into a single proceeding, Miller's directors and officers, as well as underwriters, must now defend two actions in state court and one in federal court. *Gaynor v. Miller,* 2019 U.S. Dist. LEXIS 226463 (E.D. Tenn. 2019).

Supreme Court to Consider Challenge to SEC's Power to Obtain Disgorgement

The United States Supreme Court has agreed to review a case that could decide whether the Securities and Exchange Commission (SEC) has the authority to demand and obtain disgorgement as a form of relief for a securities law violation. This has become a significant issue in light of a prior Supreme Court decision, *Kokesh v. SEC,* 137 S. Ct. 1635 (2017).

The underlying case, in which *certiorari* was granted, involves two individual defendants who allegedly raised $27 million from Chinese investors to be used to develop and build a cancer treatment center that did not materialize. The SEC filed an enforcement action in 2016 against the individuals, and eventually through the courts the individual defendants were ordered to pay $26.7 million in disgorgement. The Ninth Circuit affirmed the decision in 2018.

The individual defendants filed a petition to the United States Supreme Court asking for a review of whether the SEC has the actual authority to seek disgorgement as "equitable relief." They argue that Congress had identified the types of relief that may be awarded by an SEC enforcement action to include injunctive relief, equitable relief and certain types of civil monetary penalties, noting that disgorgement does not fit within these areas (equitable relief) and, thus, the SEC does not have the authority to obtain disgorgement. The defendants further urged the court to grant *certiorari* to address the issue that was raised by the court's former decision in the *Korkesh* case. Their brief asserts that the *Korkesh* case found that disgorgement to the SEC is a penalty and the *Korkesh* court had declined to consider whether disgorgement could be available as equitable relief in that case. The SEC asserts that disgorgement is an equitable remedy and it has the authority to obtain such relief under the Securities Act and the Exchange Act.

This case is being watched closely based on its potential broad impact on the mechanisms by which the Securities and Exchange Commission pursues its enforcement actions. If the Supreme Court finds that the SEC cannot obtain disgorgement in its enforcement actions in the court system, the SEC will have to significantly alter its current processes. *Liu v. SEC,* 2019 U.S. LEXIS 6599 (2019).

SEC Whistleblower Protections Extend Beyond Employees

The Securities and Exchange Commission (SEC) recently stated in a press release that whistleblower protections extend "beyond

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employees to protect anyone who seeks to report potential securities violations to the Commission."

The SEC issued the press release to discuss the SEC's filing of a complaint against a company and its principal who, according to the SEC, threatened investors with legal action if they reported the principal's actions to the SEC in violation of SEC Whistleblower rules. The SEC alleged that the company conditioned the return of investment to the investors based on their agreement that they would not inform the SEC of any perceived violations or company misconduct. The company sued two investors who had previously signed the agreement for breach of contract after they subsequently reported the company's activities to the SEC.

The SEC then sued the company and its principal for violating the anti-fraud and whistleblower provisions of the securities laws; specifically, Section §17(a)(1) and (3) of the Securities Act, Section §10(b) of the Exchange Act and rules 10(b)-5(a) and (c) and impeding violation of Rule 21F-17 of the Exchange Act. In addition, the SEC sought disgorgement and pre-judgment interest from the plaintiff's wife because it appeared she illegally used investor funds.

The SEC proved it would continue to support the premise that there is a basic interest in having legal violations reported to the authorities. *SEC Charges Issuer and CEO with Violating Whistleblower Protection Laws to Silence Investor Complaints,* Securities and Exchange Commission November 4, 2019 Press Release, https://www.sec.gov/news/press-release/2019-227.

Pennsylvania State Court Rejects Forum Selection Clause in Certificate of Incorporation

In response to the U.S. Supreme Court's decision in *Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund,* 2018 U.S. LEXIS 1912 (2018), which found that state courts retain concurrent jurisdiction for 1933 Securities Act liability actions, some companies contemplating an initial public offering attempted to circumvent the possibility of state court jurisdiction for securities class action lawsuits by adopting a charter provision designating a federal forum for these kinds of suits. In *Sciabacucchi v. Salzburg*, 2018 Del. Ch. LEXIS 578 (Del. Ch. 2018), however, the Delaware court declared unenforceable federal forum selection clauses in a corporate charter. *Sciabacucchi* is currently on appeal to the Delaware Supreme Court.

A Pennsylvania state court adopted the guidance of *Sciabacucchi* and rejected a company's attempts to rely on a forum-selection clause in its Certificate of Incorporation in support of dismissal, which required any suit commenced under the federal securities law to be brought in federal district court. The Pennsylvania state court noted that the parties agreed that the applicability and enforceability of the provision was governed by Delaware law. The court explained that it would defer to the only Delaware case on the issue of enforceability of forum-selection clauses – *Sciabacucchi*. The court also denied the company's attempts to stay proceedings pending the appellate decision in *Sciabacucchi*. *McComas v. Brightview Holdings, Inc.,* No. 2019-07222 (Penn. C.P. 2019).

Cases of Interest

Part I: Coverage

Claim Definition

Notice of Closure Constitutes a Claim

The United States District Court for the District of Nevada held an insurer had no obligation to defend an insured charter school because a "Notice of Closure" from the State Public Charter School Authority was deemed to be a claim made before the subject policy period.

The insured, a charter school, which operated under the oversight of the State Public Charter School Authority, was found to be derelict in certain managerial responsibilities. The Authority directed a "Notice of Breach" to the school on December 12, 2014 advising the school of its mismanagement and requiring the school take certain corrective measures. Subsequently on October 26, 2015, the school received from the Authority a "formal Notice of Closure" which outlined continued mismanagement issues, set forth a 30-day correction period, and scheduled a series of public hearings. After these hearings, the Authority petitioned the court to appoint a receiver and trustee to oversee the school. Upon granting the petition, the court required the charter school to pay the fees of the trustee. The school noticed its insurer on November 10, 2016.

The insurer declined coverage, stating the Notice of Closure was a claim made before the inception of the policy period on November 26, 2015. Conversely, the insured maintained the Notice of Closure did not meet the definition of Claim. In noting "the parties' dispute...involves a straight forward interpretation of the Policy," the court examined the definition of Claim. The Policy defines a claim as (1) "[a]ny written demand for monetary or non-monetary relief (including injunctive)" or (2) "[a]ny formal administrative, judicial, regulatory or tribunal proceeding, including any proceeding before the Equal Employment Opportunity Commission or any similar governmental agency, commenced by the filing of a notice of charges, formal investigative order, service of summons, subpoena or similar document." The court concluded that each section of the definition was satisfied, and determined that the Notice of Closure was a request for non-monetary relief, citing the Authority's mandate to the school that it take corrective action to avoid revocation of its charter. The court also found the Notice of Closure was "a formal administrative or regulatory proceeding... commenced by the filing of a notice of charges....or similar document." State law set forth an elaborate avenue whereby a charter school could have its charter revoked or terminated by the Authority, including, providing written notice of intent to revoke the charter, identifying all the reasons for revocation, providing a period for the school to cure the deficiencies, scheduling a date for an initial public hearing, and a subsequent public hearing to determine if the charter would be revoked. The court noted that "[t]he entire process is formal because it prescribes certain steps that lead to a substantive outcome—a decision about whether to revoke or terminate the school's charter. The public hearings that were held also had indicia of formality—individuals were sworn in and gave testimony under oath."

The court rejected the insured's argument that the process was not formal because the school participation in an initial board meeting was discretionary and that the Notice of Closure was simply a notice of non-compliance because it did not "assert liability, seek money damages, threaten formal proceedings or hold anybody personally liable." The court noted that "the Notice of Closure was more than a notice of non-compliance—it was the document that initiated the process for revocation or termination of [the school's] charter." Similar arguments advanced by the insured, including that the hearings were not formal in nature due to a provided cure period and there was no prior indication the Authority would seek a receiver, were similarly rejected. *Argent Preparatory Acad. v. Phila. Indem. Ins. Co*, 2019 U.S. Dist. LEXIS 34581 (D. Nev. 2019).

Prior Demands for Disgorgement of Fees Do Not Constitute Reportable Claims

In an unpublished opinion by the State of Michigan Court of Appeals, the lower court upheld summary judgment in favor of the insured. The insurer funded a multi-million dollar arbitration award on behalf of the insured and subsequently sued to recoup the funds.

The professional liability coverage dispute involved claims against the insured by its client. The insured had performed due diligence for a 2006 acquisition of a German model train maker. Following the acquisition, the client retained the insured for consulting and management services. That company performed below the expectations of the insured and caused the client to seek the return of some of the consulting fees it had paid. Subsequently, the insured recommended a restructuring, which did not result in the return on investment that was anticipated. The client sought the return of 50% of the management fees paid and the insured declined to return any of the fee.

In July 2009, the client sent the insured a draft arbitration claim and sought the return of all management fees. The client asserted that the insured had violated its duty of care in conducting the due diligence in connection with the acquisition. The matter was reported to the insurance program in August 2009. The client prevailed and received a full award, which the insurer funded. The insurer then sought recoupment on the grounds that the initial request made in 2007 for the return of consulting fees constituted a claim made prior to the policy term. The insurer took the position that the initial request for the return of fees constituted a "Claim."

The insured successfully argued that there was no obligation to report any of the demands for return of fees as such disputes were fully excluded by the professional liability insurance program. "We concur with the trial court's determination that the defendant had no responsibility to report the [earlier] ... claims because of the exclusionary language of the contract regarding fee disputes." *Ill. Nat'l Ins. Co. v. AlixPartners LLP*, 2019 Mich. App. LEXIS 402 (Mich. App. 2019).

Civil Investigative Demand is a Claim Alleging a Wrongful Act

The Superior Court for the State of Delaware held that a civil investigative demand ("CID") is a Claim under a Professional Liability insurance policy.

The insured's business involved processing "prior authorization" requests from orthodontic providers under Medicaid. In conjunction with its business operations, the insured received a CID from the Texas

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Attorney General indicating that the AG was "investigating the possibility of Medicaid fraud involving the prior authorization process for orthodontia services." The CID also stated that the AG "has reason to believe you may have information relevant to its investigation."

The insured sued, alleging that its insurer breached its obligations by failing to defend and indemnify the insured for the CID and two related groups of lawsuits. On the insurers' partial motion to dismiss, the court was tasked with considering whether the CID triggered the insuring agreement. It specifically considered whether the CID was (1) a Claim (2) alleging a Wrongful Act.

The policy defined Claim as "(1) a written demand for money, services, non-monetary relief or injunctive relief; or (2) a Suit." The court reviewed a national split of authority before finding that the more persuasive authority supported the proposition that a CID is a Claim. The court agreed with the insured that the CID was a "demand for... non-monetary relief." It distinguished the "no Claim" opinions because they did not address the "ability of the issuer to compel compliance without judicial intervention."

The court also addressed whether the CID alleged a Wrongful Act, as required by the insuring agreement. The CID stated that the AG was "investigating the possibility of Medicaid fraud involving the prior authorization process for orthodontic services. Such activities may violate the Texas Medicaid Fraud Prevention Act... and other law." In the court's words, "Medicaid fraud clearly would be a Wrongful Act." The court specifically stated that it was not persuaded by the argument that "investigating an alleged unlawful act by the insured, is different from actually alleging an unlawful act," finding that this was a "distinction without a difference." Accordingly, the court found in favor of coverage and denied the insurers' partial motion to dismiss. *Conduent State Healthcare, LLC v. AIG Specialty Ins. Co.,* 2019 Del. Super. LEXIS 298 (Del. Super. 2019).

Department of Labor Inspection Request is Not a Fiduciary Claim

The United States District Court for the Southern District of Iowa considered whether a letter from the Department of Labor ("DOL") was a claim under a fiduciary liability policy. Because the letter did not allege a "wrongful act" per the policy, the court held that it was not a "claim."

The insured purchased claims-made fiduciary liability policies for the 2014-2016 period and the 2016-2017 period. The definition of "claim" included "a written notice of commencement of a fact-finding investigation by the U.S. Department of Labor ... against an Insured for a Wrongful Act." The policies defined a "wrongful act" to include: "1) any breach of duties imposed by ERISA committed or allegedly committed by an Insured; 2) any negligent act, error, or omission in Administration of any Plan committed or allegedly committed by an Insured; or 3) any other matter claimed against an Insured solely by reason of the Insured's services as a fiduciary."

During the first policy period, the insured received a two-page letter from the DOL, requesting inspection of its various employee stock ownership plan documents pursuant to a DOL investigation. The insured did not notice the DOL letter at the time. During the second policy period, a former employee filed suit on behalf of a stock plan at issue. The insured later received another letter from the DOL, advising of the insured's possible breach of fiduciary obligations and violation of ERISA provisions. The insured provided prompt notice of both the suit and second DOL letter.

Upon review, the court refused to find a "wrongful act" alleged in the initial DOL letter, which it determined was "not a notice of investigation for a breach or alleged breach" of the insured's duties under ERISA where there was no assertion of an ERISA violation or any mention that a violation was suspected. The court also determined that the first letter was not a notice of investigation, per the policy language, "for any other matter claimed against an Insured solely by means of the Insured's service as a fiduciary." The insurer argued that the letter's request for records and demand for on-site examination alleged a "wrongful act" per the policy. However, the court found that such an interpretation ignored the that the definition required a violation of a legal obligation, which was not indicated by the DOL letter. The court concluded that the initial letter was not a claim and thus, the insured's failure to give notice thereof was not a valid basis for denial. *Telligen, Inc. v. Atl. Specialty Ins. Co.,* 2019 U.S. Dist. LEXIS 175702 (S.D. Iowa 2019).

Related Claims

Formal Order of Investigation is a Claim and Related to Subsequent Enforcement Action

The United States Court of Appeals for the First Circuit affirmed a summary judgment ruling that the different stages of an SEC investigation that spanned several years were one "Claim" first made when the insured received an SEC Formal Order of Investigation ("2011 SEC Order") and subpoenas before inception of the insured's 2011-12 directors and officers liability policy ("Policy").

In May 2011, the SEC issued the 2011 SEC Order to the insured with document subpoenas. The Insured retained counsel, but did not notify the then insurer of the commencement of the SEC investigation. In November 2011, the Insured purchased the Policy from a new insurer ("Insurer") and stated in the application that there were no pending legal claims. In January 2012, the SEC served deposition subpoenas on the insured's CEO and others. In March 2012, the SEC served additional document subpoenas on the Insured and its CEO. Significantly, all the 2012 subpoenas had the same caption as the 2011 SEC Order and the 2011 subpoenas. After receiving the March 2012, subpoenas, the insured notified the Insurer of the January and March 2012, subpoenas. Eventually, in December 2012, the SEC commenced an Enforcement Action ("2012 Action") against the insured and its CEO.

The Insurer acknowledged that the SEC investigation constituted a "Claim" under the Policy, but denied coverage because the SEC investigation was a "Claim" that was first made in May 2011, prior to inception of the Policy. The insureds commenced a coverage lawsuit against the Insurer. The lower court ruled in favor of the Insurer and the insureds appealed.

On appeal, the court rejected the insureds' argument that the component parts of the SEC investigation were each separate "Claims"— noting that each SEC subpoena

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is not a Claim because subpoenas do not seek "relief" as defined in Black's Law Dictionary ("[t]he redress or benefit, esp. equitable in nature (such as an injunction or specific performance) that a party asks of a court" (emphasis added by court). Also, the court noted that the "Claim" definition included investigations "commenced by" various documents, including subpoenas and it would be illogical to interpret the Policy as stating a subpoena alone is an independent "written demand [for] non-monetary relief."

Further, the court reasoned that even *assuming arguendo* the component parts of the investigation were separate "Claims", under the Policy's interrelated wrongful acts provision, they would still be a single "Claim" that was "first made" at the time the 2011 SEC Order. Notably, the appeals court rejected the insureds' position that the interrelated wrongful acts provision could not apply because the 2011 SEC Order and 2011 subpoenas did not allege "Wrongful Acts." Lastly, the appeals court ruled that there was sufficient "overlap" between the conduct at issue in the 2011 SEC Order and the 2012 subpoenas and the 2012 Action to constitute interrelated wrongful acts. *BioChemics, Inc. v. AXIS Reinsurance Co.*, 2019 U.S. App. LEXIS 15326 (1st Cir. 2019).

Court Holds Claims were Causally Related and thus a Single Claim

The United States District Court for the Northern District of California held that, under California law, two complaints against an insurance brokerage arising out of a series of related wrongful acts were deemed a single claim, and coverage was therefore barred under the brokerage's later-issued policy.

The insurer issued Insurance Professionals Errors and Omissions Liability Insurance ("E&O") policies to the insured, an insurance brokerage firm, for the 2016 and 2017 calendar years. The 2016 policy had a $1,000,000 limit, and the 2017 policy had a $2,000,000 limit.

The insured brokerage procured property insurance for its client. The broker used an online quote system that included a question asking whether the property was sprinklered and mistakenly checked the box indicating that all four buildings were sprinklered, even though only two units out of four buildings had sprinklers. As a result, the insurer issued a property policy to the client that excluded coverage for fire damage if the property lacked a working sprinkler system before the fire.

The client suffered fires at two of its properties and the insurer denied the claims based on the sprinkler exclusion. The client sued the insured alleging that the broker breached its duty of care "when, knowing [the client] sought a policy that would cover property damage at the property, including caused by fire, [the broker] procured ... a policy with an endorsement that lead [sic] to the denial of coverage."

The E&O insurer accepted the brokerage's tender of defense of the client's lawsuit under the 2016 policy, but denied coverage under the 2017 policy, because the claims made during that policy period were based on the same or related wrongful acts giving rise to the claims made during the 2016 policy's policy period. The insured's 2016 and 2017 E&O policies both provided that:

> [t]wo or more covered claims arising out of a single wrongful act or arising out of any series of related wrongful acts will be considered a single claim. The single claim will be subject to the "Limit of Liability — Each Claim" in effect at the time such claim was first made against the Insured. Only one deductible will apply to such single claim. If the first of such claims is made prior to the effective date of this policy, no coverage shall apply to any subsequent claims made during this policy period which are based upon the same or related wrongful acts.

Neither policy defined "related."

The insurer sought a declaratory judgment that "the allegations made against the insured in the [client's] action represent a single 'claim,' subject to the $1,000,000 Each Claim limit of the 2016...policy" and "that no coverage is afforded under the 2017...policy."

The district court held that the claims based on the 2016 and 2017 fires arose out of a "series of related wrongful acts." The court found that "the term 'related' as it is commonly understood and used encompasses both logical and causal connections." "Thus, errors are 'related' if one 'error causes one or more other errors.'" The court rejected the insured's argument that there could be no causal relationship because the alleged negligence occurred years apart and involved different staff and held that but for the insured's alleged negligence, the sprinkler exclusion would not have been part of the policy at all. *General Ins. Co. of Am. v. INB Ins. Servs. Corp.*, 2019 U.S. Dist. LEXIS 48362 (N.D. Cal. 2019).

Prior Acts Exclusion Bars Coverage for Wrongful Acts that Occurred Both Before and After Prior Acts Date

A district court recently held that an insured is not entitled to coverage under its excess directors and officers liability ("D&O") policy based upon a prior acts exclusion.

Securities class actions and derivative actions were filed against the insured alleging the insured failed to disclose that it used third party relationships to understate costs of goods sold and overstate earnings and profits. The insured submitted the claim to its primary and excess D&O policies. Both policies contained prior acts exclusions for any wrongful acts prior to August 20, 2012 ("prior acts date"). The primary policy's exclusion provided that "the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging any Wrongful Act occurring prior to [prior acts date]... Loss arising out of the same or related Wrongful Act shall be deemed to arise from the first such same or related Wrongful Act." The excess policy provided that "[t]his Policy shall follow any exclusion in the Primary Policy..."

Interestingly however, an additional prior acts exclusion in the excess policy provides that "[t]his Policy shall not cover any Loss in connection with any claim alleging, arising out of, based upon, or attributable to any wrongful act(s) committed, attempted, or allegedly committed or attempted prior to [prior acts date]."

The insured ultimately settled both the securities class actions and derivative actions. Despite initially reserving its rights with respect to the prior acts exclusion, the primary insurer paid $9.5 million of its $10 million limit toward settlement and defense. The insured paid the remaining $500,000 in acknowledgement of the primary insurer's

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need for a "discount in respect of coverage issues remain[ing]." The excess insurer invoked the prior acts exclusion and denied coverage. The insured disagreed and litigation with the excess carrier ensued.

The court's review focused on the language of the excess policy's prior acts exclusions. While the excess policy followed form, the court noted that the prior acts exclusion was broader than that in the primary policy. The court opined that the excess policy "also broadens the definition of 'arising out of' by adding the language 'based upon, or attributable to' and using the word "any" three times: any Loss, any claim, any wrongful act. Read as a whole, the Excess Policy exclusion is broader than the Primary Policy, adding terms 'based upon, or attributable to' and 'any' to weaken any direct liability causation requirement that may be read into 'arising out of' and to emphasize that prior acts leading to claims within the policy period will not be covered." The court further concluded that alleged wrongful acts occurring after the prior acts date "arose from the same nuclei of wrongful conduct" as the alleged wrongful acts that occurred before the prior acts date. Accordingly, the court held that the insured was not entitled to coverage under the excess policy. *Tile Shop Holdings, Inc. v. Allied World Nat'l Assur. Co.,* 2019 U.S. Dist. LEXIS 93238 (D. Minn. 2019).

Insured Definition

New Spin-off Church is not an Insured under Original Church's D&O Policy

According to the allegations in the complaint, 80% of the members of a church left their church to form a new church because they disagreed with church policy and its decision to allow lesbian, gay, bisexual, and transgender people into the clergy and to recognize same-sex marriage. Days later, the new church submitted documentation changing the entity name of the church. The new church also took control of the original church's property. The original church then sued the new church entity seeking a declaration that the original church was the owner of the property. The new church submitted that lawsuit as a notice to the original church's directors and officer's (D & O) insurer requesting a defense under that policy. The carrier denied coverage and the new church sued the carrier in a declaratory judgment action.

The court agreed with the insurer that the policy clearly excluded coverage sought by the new church because it was not an insured under the policy definition. The new church was considered a legal entity distinct from the original church, and thus, not an insured. Additionally, the court held that the alleged wrongful acts would not constitute covered wrongful acts because they were not "solely by reason of their status" and did not "aris(e) out of their service" as directors and officers of the original church. Therefore, there was no coverage and the complaint against the insurer was dismissed. *Newton Covenant Church v. Great American Ins. Co.,* 2019 U.S. Dist. LEXIS 128326 (D. Mass. 2019).

Medical Group Not an Insured Under Affiliate's Policies

The Court of Appeals for the Eleventh Circuit affirmed a lower court ruling for the insurer that the insurer was not required to provide coverage to a medical group under a Professional Employer Organization's (PEO) Employment Practices Liability (EPL) policy because the group did not have a valid contract under state law with the PEO.

The medical group, which utilized the services of the PEO, submitted two claims made against it to the PEO's EPL insurer. The insurer initially defended the group under a reservation of rights, but later denied the claim saying that the medical group did not have a written employee leasing agreement with the PEO at the time of the claim and was not an insured. The medical group lost its suit at the district court level and subsequently appealed.

The 11th Circuit affirmed, finding that the documents the medical group presented; an email, a brochure, and a letter to an insurance company designating the PEO as its insurance agent, did not constitute a written agreement under Florida law. These documents did not describe the co-employer relationship between the parties, reserve control over the employees for the PEO, reserve ability to hire, fire, discipline or reassign employees for the PEO or require the PEO to provide written notice of the relationship between the parties to the leased employees as required by Florida statute. Therefore, as there was no written agreement between the parties, the district court was correct in granting summary judgment to the insurer. *THM Med. Servs., LLC v. National Union Fire Ins. Co.,* 2019 U.S. App LEXIS 35954 (11th Cir. 2019).

Fraudulent Instruction

Combination of Communications Constitute Fraudulent Instruction and Caused Direct Loss

The United States Court of Appeals for the Eleventh Circuit affirmed that a fidelity policy covered the insured's loss of funds wired to phishing scam fraudsters. The court held that the insured suffered a direct loss despite the involvement of the insured's bank and an individual purporting to be outside counsel. The court further held that the insured received a "fraudulent instruction" to transfer money per the policy language.

The insured's controller received an email purporting to be from its managing director. The email asked the controller, in furtherance of the insured's secret and "key acquisition," to wire money pursuant to details that an outside attorney would provide. The email gave the name of this supposed attorney and requested that the controller treat the matter confidentially and "deal solely" with the attorney. The controller then received an email purporting to be from the attorney, who specified the transfer amount and remittance details to a bank in China. Once the controller approved the transfer, the fraud prevention service of the insured's bank requested verification of the transfer's legitimacy. In response, the controller confirmed with the attorney that the managing director had approved the transfer and relayed this to the bank. The controller discovered the request was fraudulent the next day.

At issue were: 1) whether the insured had received a "fraudulent instruction" per the policy and 2) whether the loss directly resulted from the purported managing director's email. The policy required that the "fraudulent instruction" "direct a financial institution to...transfer...money...from [the insured's] account." The insurer asserted that no "fraudulent instruction" was involved, since the purported managing director's email did not specify an amount of money or recipient. Instead, only the purported outside

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attorney's email contained these details such that no coverage was afforded. Per the policy's definition, a "fraudulent instruction" needed to come from a sender purporting to be an employee. In rejecting this "divide-and-conquer approach," the court determined that the combination of both emails "unambiguously" qualified as a fraudulent instruction. Further, the insured's loss directly resulted from the managing director's email. Georgia precedent permitted a proximate cause "direct" loss analysis. In finding this, the court refused to see the controller's communications with the outside attorney and the bank's involvement as severing the causal chain. Both events, according to the court, were foreseeable consequences of the purported managing director's email, since it directed the controller to deal with the attorney. *Principle Sols. Grp., LLC v. Ironshore Indem., Inc.,* 2019 U.S. App. LEXIS 36350 (11th Cir. 2019).

Notice

Court Holds Whistleblower Complaint and Subpoena Reported Untimely

This coverage dispute addressed whether a whistleblower complaint and subpoena were reported timely under a Directors and Officers Liability claims-made-and-reported policy. The court held that the insured did not satisfy the reporting requirements in the policy regarding the complaint and subpoena because although they were considered first made in the 2015-2016 policy, the insured did not report the matters until a year after the 2015-2016 policy had expired, and the insured had already settled the whistleblower complaint.

The insured first argued that the policy periods under each installment of the policy should be treated as one contiguous policy period since it had renewed the D&O policy with the same insurer for several years. The court rejected this argument finding that the renewal of a policy does not extend a policy's reporting period. "Therefore, the fact that [the insured] renewed the 2015-2016 Policy through the issuance of the 2016-2017 Policy has no relevance to [the insured's] reporting requirements under the 2015-2016 Policy…"

The insured next argued that notice was timely because the claims were not first "made" until the Department of Justice (DOJ) sent a letter to the insured stating that the criminal investigation pursuant to the subpoena was concluded and that the DOJ did not intend to pursue criminal charges against the insured or its employees. This was after the 2016-2017 policy became effective. According to the insured, it was not legally able to provide notice of the subpoena or the whistleblower action because the DOJ requested that the insured not disclose the existence of or compliance with the subpoena without advance notice to the DOJ. The court found that the DOJ's cover letter did not affirmatively prohibit the insured from disclosing these actions to the insurer. Rather, the insured could have sought the DOJ's permission to provide notice to the insurer so that the insured could seek insurance coverage for these actions, but the insured did not do so.

Finally, the insured argued that it should be excused from its deficient notice under the "notice-prejudice" rule. The court held that under California law the notice-prejudice rule does not extend to claims-made policies on the ground that the insurer has a right to limit the scope of the coverage it provides as set forth in the plain language of the policy. Here, the policy makes timely notice of a claim made during the policy period an explicit "condition precedent" to the insurer's obligations to provide coverage to the insured for any claims otherwise covered. *PAMC, Ltd. v. Nat'l Union Fire Ins. Co.*, 2019 U.S. Dist. LEXIS 28538 (C.D. Cal. 2019).

Late Notice Precludes D&O Coverage Under California Law

An insured that had purchased four successive terms of directors & officers liability insurance initiated litigation against its insurer following a declination of coverage on late notice grounds. After extensive choice of law analysis, the Sixth Circuit Court of Appeals applied California law in upholding the carriers' declination of coverage.

The first policy incepted on July 31, 2013 and was renewed three times. For each renewal, the insured executed a renewal application that included a question regarding whether any litigation had been filed against any insured within the prior three years. The insured responded in the negative on each application. The renewal application for 7/31/15 – 7/31/16 was executed in July 2015. In May 2015, a lawsuit was filed against one of the insured entities, with service of process effective as of June 10, 2015. The litigation was not identified in the renewal application. Notice of the litigation was provided on January 8, 2016, over five months after expiration of the policy term in which the claim was made. The insurer declined coverage on late notice grounds. As an additional basis for denial, the insurer asserted that a material misrepresentation had been made in the renewal application because the litigation was not disclosed.

The court noted that the policy unambiguously required notification of claims not later than 60 days after expiration of the policy period. Although the insured argued that the reporting period was extended due to the renewal of the insurance program, the court found important the difference between claims-made and occurrence-based insurance programs. The additional grounds for declining coverage, material misrepresentation in the renewal application, were also upheld by the court, which found that materiality was established because the litigation was pending at the time the insured responded that no litigation had been filed in the prior three-year period. *US HF Cellular Communs., LLC v Scottsdale Ins. Co.,* 2019 U.S. App. LEXIS 20324 (6th Cir. 2019).

Eight Month Delay in Reporting Claim Found Not to be As Soon As Practicable

A district court held that an insured failed to provide notice of a claim "as soon as practicable" as required by its Businessowners Policy.

The insured, a provider of software and consulting services, filed suit against one of its customers for breach of contract. The customer filed a counterclaim against the insured for breach of contract and breach of warranty. The insured provided notice to its insurer approximately one year after the counterclaim was filed and four days prior to the close of discovery. The insured argued it failed to provide notice because the employee responsible for managing insurance coverage issues was terminated during this period and never informed the insured regarding the need to provide notice of the counterclaim to the insurer.

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The policy's insuring agreement provided that "[t]his insurance only applies if ... the 'claim' is first made against 'you' during the 'policy period' or any extended reporting period we provide and the 'claim' is reported to us as set forth in SECTION E – CONDITIONS ...." Section E provides in relevant part that "[i]f a 'claim' is made against 'you,' you must see to it that we receive written notice of the 'claim' as soon as practicable..." The insurer sought a declaratory judgment that it did not have a duty to defend or indemnify the insured due to the untimely notice of the counterclaim. The insurer argued that it was denied its right to investigate and defend the suit which resulted in prejudice to the insurer. The insurer further argued that "timely notice 'as soon as practicable' was a condition precedent to the applicability of the Policy it issued to [the insured]... "

The court concluded that "one of the conditions required for attachment of insurance coverage under the policy is that the insured provide notice to the insurer of any 'claim' covered by the agreement 'as soon as practicable.'" The insured countered that the policy did not include the language "condition precedent to coverage," and, therefore, the notice requirement of "as soon as practicable" is not a condition precedent. The court disagreed, concluding that the policy did not have to include the specific term "as a condition precedent to coverage" and held "that the plain language of the Policy establishes notice 'as soon as practicable' as a condition precedent to the Policy's insurance coverage."

The court agreed with the insurer that notice was not given as soon as practicable and that "the negligence of an employee does not excuse the company's failure to comply with a contract." The court also determined "that the notice requirement is 'material' to the insurance agreement, and therefore cannot be excused." Finally, the court held that while a showing of prejudice is not required under a claims-made policy, "there is no genuine dispute of material fact that [the insurer] was prejudiced by [the insured's] delayed notice." *Citizens Ins. Co. of Am. v. Assessment Sys. Corp.*, 2019 U.S. Dist. LEXIS 145082 (D. Minn. 2019).

Claim was Late Despite Continuity of Coverage

The Court of Appeals of Ohio upheld a lower court's ruling that a claims-made policy barred coverage for a claim first made in a prior policy, despite the fact that there was continuity of coverage with the same insurer.

In January 2014, the insured received a letter from the prior employer of various new hires. The letter requested that the insured acknowledge certain post-employment obligations those new hires owed to the prior employer. One month later, the prior employer filed suit against the insured and several individuals. The insured did not report the matter to its insurers until August 2015, when it formally advised its Directors & Officers Liability ("D&O") insurer. The D&O insurer had written three consecutive claims-made policies for the insured for the periods 2013-2014, 2014-2015, and 2015-2016. The claims-made policies contained a notice provision dictating that: 1) written demands made during the policy period shall be noticed prior to the end of the policy period; or 2) civil proceedings made during the policy period shall be noticed as soon as practicable after a member of the control group has knowledge of the Claim, but in no event later than 90 days post expiration. The policies contained a savings clause that stated: "the Insureds failure to report a Claim pursuant to (1) above shall not negate the right to report a Claim pursuant to (2) above under this Policy or any renewal thereof."

The insurer denied coverage on the basis that the lawsuit was not timely noticed where the suit was filed during the 2013-2014 policy but not noticed until the 2015-2016 policy period. The insured sued the insurer for breach of contract for failure to defend and indemnify and the trial court granted the insurer's motion to dismiss.

On appeal, the insured cited to various cases that had confirmed coverage based on lack of prejudice and/or continuity of coverage.

The court, however, distinguished all of those cases because the policy wording was significantly different. The court rejected the notice prejudice rationale because of the policy's strict date requirements for notice.

The court also considered the impact of the savings clause on coverage. It stated: "reading definitions of claim together with the "savings clause," the "savings clause" provides that if the insured fails to report a written demand for relief, that failure will not negate the insured's right to report a civil proceeding under the policy or any renewal of the policy." The insured argued that because the letters constituted demands, they invoked the savings clause, such that failure to report the letters would not preclude the subsequent notice of the lawsuit. The court rejected that argument for two reasons. First, the letters were not "claims" because they did not demand anything. Second, the insured's interpretation of the savings clause rendered the second part of the notice provision meaningless. The court affirmed the lower court's grant of the insurer's motion to dismiss. *ISCO Indus. v. Great Am. Ins. Co.,* 2019 Ohio App. LEXIS 4949 (Ohio 1st Dist. 2019).

Securities Claim Definition

Delaware Court Finds Appraisal Claims are Securities Claims

A Delaware Court found that an appraisal action is a "Securities Claim" as defined by a Directors and Officers Liability ("D&O") Policy.

In the underlying appraisal action, the plaintiffs sought the fair value of shares to be tendered pursuant to a merger agreement. Following commencement of the action, the insured tendered the matter to its D&O insurers, which denied the claim based upon their position that the appraisal action was not a Securities Claim. Securities Claim was defined as a claim for ".... any actual or alleged violation of any federal, state or local statute; regulation or rule; or common law regulating securities." The insurers argued that the appraisal action did not allege any wrongdoing by the insured. The insured argued, and the court agreed, that the suit does not need to allege wrongdoing but rather the term "violation" was broad enough to include the accusation within the appraisal action that the company had not provided its shareholders with "'fair value' for their shares when they are cashed out of their positions through certain types of mergers or consolidations."

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The underlying appraisal action resulted in a finding that the value of the shares was $53.95 - plus pre-judgment interest in excess of $38 million. While the court noted that insurers and insured agreed that the fair value of the shares, as determined by the court, was not covered Loss - they disagreed on the coverage for the pre-judgment interest awarded by the court. The insurers asserted that since the fair market value was not covered Loss, it followed logically that the interest on that amount was uncovered as well.

In reviewing the definition of Loss within the policy, the court found it unambiguous, and that Loss included "pre-judgment and post-judgment interest…." The court noted that the insurers' argument that coverage for pre-judgment interest must be tied to an interest award on a covered judgment was not reflected within the policy language. Thus, the court found that pre-judgment interest would be encompassed within the definition of Loss but did not award such in its ultimate decision pending a further inquiry on facts which were not within the record. *Solera Holdings, Inc. v. XL Specialty Ins. Co.,* 2019 Del. Super. LEXIS 361 (Del. Sup. Ct., 2019).

Bond Coverage

Court Rejects Bond Insurer's Narrow Construction of the Bond's "Securities" Insuring Agreement

The United States District Court for the District of Arizona rejected a financial institution bond insurer's attempt to avoid coverage for a bank's losses resulting from a borrower's use of forged documents to obtain a $3.6 million loan.

The underlying dispute arose out of the insured bank's loan to a medical equipment company. The company obtained this loan to purchase two other medical equipment companies, and to pay off an existing loan with a different bank. Because the loan amount did not cover the entire purchase price of the two other companies, the insured required that the company not make any additional payments to other creditors during the first four years of the repayment plan. The insured bank obtained standby creditor's agreements from two individual sellers that required them to pay to the insured any payments the company made to them during this four-year period. The insured bank subsequently exercised its right of receivership under the loan agreement with the company and discovered that it had not been truthful in its loan application and that the standby creditor's agreements were forged.

The insured notified its bond insurer of a claim resulting from the forged standby creditor's agreements and submitted a proof of loss, which requested that the insurer consider the claim under both the 2013-2014 and 2014-2017 bonds. The bond insurer denied the claim and the bank filed suit.

The bonds provided coverage for:

Loss resulting directly from [the insured] having, in good faith, for its own account or for the account of others, … acquired, sold or delivered or given value, extended credit or assumed liability on the faith of, and Written, Original … personal Guarantee… or Security Agreement.

The bond provided coverage for forged "guarantees," which were defined as a "[w]ritten undertaking obligating the signer to pay the debt of another, to the Insured … if the debt is not paid in accordance with its terms."

The court considered: (1) whether the forged standby creditor's agreements are covered by the bond as either a "security" or a "guarantee," and if so, (2) whether the notice prejudice rule applies to the bond.

Applying Arizona law, the court rejected the bond insurer's arguments that 1) the loss did not trigger one of the bond's insuring agreements; and 2) that the notice prejudice rule did not apply to the bond's coverage. The court concluded that the creditor's agreements fell within the bond's definition of "Guarantee" and that a "Guarantee" does not have to create an obligation to pay the entire debt. The court found that the bond is not an occurrence policy, because it does not provide coverage for any fraudulent act or omission that occurs during the policy period nor is it a claims-made policy because coverage is not triggered by notifying the bond insurer of the loss. Rather, coverage under the bond "applies to loss first discovered during the policy period," not to a loss first reported to the bond insurer during the policy period. The court stated that the bond merely requires that the insurer provide coverage for claims that are discovered and reported within the policy period if it has not been prejudiced by a late notice. *MBP Collection LLC v. Everest Nat'l Ins. Co.*, 2019 U.S. Dist. LEXIS 1518 (D. Ariz. 2019).

Loss Definition

Settlement Amounts Considered "Loss"

The Delaware Superior Court recently addressed several coverage issues involving whether settlement amounts were "Loss" under a directors and officers liability policy, and whether consent was provided, as well as whether the insurers acted in bad faith in asserting a denial position on the claim.

Underlying this protracted coverage battle is a 2013 transaction in which a food company's chairman and CEO, acquired the company's shares in a take-private transaction. The transaction spurred various lawsuits, including one in which the Delaware Chancery Court found breaches of fiduciary duty. In that case, the stockholders alleged that the defendants manipulated the stock price so that the CEO could acquire the stock at a lower price. The Delaware Chancery Court repeatedly cited to "fraudulent activity" in its opinion, determined that the duty of loyalty was breached, and assessed liability of over $148 million. The parties mediated and agreed to a formal settlement in 2015.

While the approval of the settlement was pending, shareholders filed a securities class action against the company and CEO in federal court. The plaintiffs in the securities lawsuit alleged that the company and its CEO deceived investors in connection with the company's take-private transaction. Following mediation, the securities lawsuit ultimately settled for $74 million.

Various excess insurers sought a declaratory judgment that there was no coverage under their policies. The insured company and the other defendants had asserted that the insurers breached the implied covenant of good faith and fair dealing in denying coverage for the underlying settlements. The court, however, found that the insurers advanced several well-reasoned arguments for denying coverage– *e.g.*, the policy's fraud exclusion and failure to comply with the written consent provision and the

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cooperation clause. The court also determined that the insurers' attempt to apply California law instead of Delaware law in interpreting the policy, was reasonable, but incorrect. Thus, the court found that the insurers did not act in bad faith in asserting their coverage positions.

The court also issued an order granting summary judgment in favor of the insured with respect the insurers' contention that the settlement amounts did not represent a "loss" under the policies but merely an increase in the consideration for the take-private transaction. In rejecting the insurers' argument, the court noted that the policies' definition of loss specifically stated that the term "loss" includes "settlement amounts." The court also scrutinized the provision in the definition of "loss," which specified that loss does not include amounts of increased transactional consideration paid by "the Policyholder." However, here the company's CEO, who was not the "Policyholder," paid the Chancery Court settlement. Further, even though the company paid part of the securities class action settlement, the settlement was a "Loss" because the company did not acquire shares in connection with the merger (as required to be excepted from the definition of Loss).

The court also noted that "consent-to settle provisions do not provide an insurer with an absolute right to veto a reasonable settlement." Rather, the "main purpose" of the consent provision is "to protect the insurer from prejudice or a collusive settlement." While the court found that the insurers did not provide prior written consent to the settlements, the court noted that a question of fact exists as to whether the insurers unreasonably withheld their consent. The court then stated, "(w)hether the Insurers had enough time to consent and whether the Insurers placed the Insureds in an untenable position [settling and losing coverage or proceeding with litigation and then potentially not being able to recover] are questions of fact to be determined by a jury." Moreover, with respect to the cooperation clause, the court found that there were disputed issues of material fact regarding whether there was a "substantial breach of the cooperation provision." The court explained that there were factual issues of whether the defendants had withheld information that the insurers requested, whether such information requests from the insurers were reasonable, whether the insurers' coverage denial gave the defendants the right to enter into a reasonable settlement, and whether the settlements were fair and reasonable under the circumstances. *Arch Ins. Co. v. Murdock*, 2019 Del. Super. LEXIS 222 (Del. Super. Ct. 2019); *Arch Ins. Co. v. Murdock*, 2019 Del. Super. LEXIS 227 (Del. Super. Ct. 2019).

Part II: Exclusions

Conduct Exclusion

Conduct Exclusion Bars Coverage under D&O Policy

The United States Court of Appeals for the Eleventh Circuit found in favor of an insurer based on application of the policy's conduct exclusion. The underlying case involved a Securities Exchange Commission ("SEC") civil action against a company and its owner for violation of the securities laws. The suit alleged that the owner violated the securities laws by, among other things, "knowingly making and disseminating blatantly false and deceptive material statements as part of a fraudulent scheme." The district court ultimately entered summary judgment against the owner and imposed more than $3 million in civil remedies; the decision was affirmed on appeal.

Subsequently, the owner filed an action against its directors and officers liability ("D&O") insurer seeking indemnification. The D&O policy provided coverage for "any civil or criminal actions brought by the SEC for violations of any securities rules or laws." However, the policy excluded claims "brought about or contributed to by... the deliberately fraudulent or criminal acts of any insureds where it is finally adjudicated that such conduct in fact occurred." The district court granted the insurer's motion to dismiss based on failure to state a claim, because the individual "was found to have committed intentional fraud in his securities transactions."

On appeal, the Eleventh Circuit affirmed, holding that the conduct exclusion barred coverage in its entirety because there was a finding in the SEC action that the owner engaged in deliberately fraudulent conduct when he "knowingly [made] blatantly false and deceptive material statements... to potential investors." *Imperato v. Navigators Ins. Co.*, 2019 U.S. App. LEXIS 17359 (11th Cir. 2019).

Third-Party Conduct Does Not Trigger the Fraud Exclusion

The United States District Court for the Southern District of New York held that the fraud exclusion in an errors and omissions policy was not triggered when the fraud was committed by third-party fraudulent actors and not the insured.

The insured is a global provider of software and software-enabled services that provides, among other things, business processing management. For several years, the insured acted as fund administrator for its client, an investment fund. The insured was responsible for holding the client's funds and dispersing them under the client's direction. Criminals used "spoofed" e-mail addresses to send forged transfer requests to the insured. The insured received the wire transfer requests and—believing them to be from the client—processed them according to the terms of its contract with the client.

The client sued the insured and alleged that the insured was grossly negligent in handling the client's funds, breached its services contracts, and breached the implied covenant of good faith and fair dealing. The insured provided timely notice of the claim to its E&O insurer, which agreed to provide a defense but denied indemnity coverage for the settlement of the claim. The insured subsequently filed suit and sought a determination that coverage was available under the policy.

The conduct or fraud exclusion in the policy excludes coverage for losses "alleging, arising out of, based upon or attributable to a dishonest, fraudulent, criminal or malicious act, error or omission, or any intentional or knowing violation of the law; provided, however, [the insurer] will defend Suits that allege any of the foregoing conduct, and that are not otherwise excluded, until there is a final adjudication against an Insured . . .." The insurer argued that the "plain reading of the first clause before the 'provided,

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however' clause dictates that [the exclusion] applies not only to 'dishonest, fraudulent, criminal or malicious act, error or omission, or any intentional or knowing violation of the law; committed by [the insured], but also broadly to such acts committed by third-party fraudsters, such as here." The court disagreed and concluded that the insurer's interpretation fails when the sentence in the exclusion is read in its entirety. The court determined that "coupling the first clause with the 'provided, however' clause of the same sentence clearly indicates that [the exclusion] applies only to dishonest, fraudulent, criminal, or malicious acts committed by [the insured], and not to these such acts committed by third-party fraudsters." The court added that this interpretation is most likely what the parties intended when they entered into the policy. In addition, the court found that the insurer had been acting in bad faith when it changed its original position that a final adjudication that the insured acted with the third-party fraudsters could exclude indemnity coverage and trigger the insurer's right to recoup defense fees. The court held that the fraud exclusion did not apply to fraudulent conduct by third parties, and, therefore, did not preclude indemnity coverage for the insured in the underlying claim. *SS&C Tech. Holdings v. AIG Specialty Ins. Co.,* 2019 U.S. Dist. LEXIS 194196 (S.D.N.Y. 2019).

Contract Exclusion

Breach of Contract Exclusion Renders Errors & Omissions Coverage Illusory

The United States Court of Appeals for the Seventh Circuit determined that a broad breach of contract exclusion inserted by endorsement rendered the insured's Errors & Omissions and professional liability coverage illusory.

The insured contracted with a customer to build an anaerobic digester. Thereafter, the customer sued the insured for breach of contract, alleging that the insured "failed to fulfill its design duties, responsibilities, and obligations under the contract in that it did not properly design substantial portions of the structural, mechanical, and operational systems of the anaerobic digester." The insured noticed the lawsuit to its E&O insurer, which initially provided a defense, but later denied coverage asserting that the policy's breach of contract exclusion, which applied to claims "based upon or arising out of" breach of contract, completely barred coverage for the lawsuit.

The insurer sought declaratory judgment based on the exclusion. The insured maintained that the exclusion was so broad that it effectively rendered coverage illusory. The district court held that the breach of contract exclusion did not render coverage illusory because coverage would still apply to third party claims. The Seventh Circuit disagreed, ruling that the exclusion "is extremely broad" and excludes coverage for all claims for professional liability, even third-party claims. The court stated that "Wisconsin courts have made clear that the 'arising out of' language is broadly construed." The court noted that "all that is required is some causal relationship between the injury and the event not covered which sweeps in third-party claims as well when so related."

Consequently, the court ruled that the contract exclusion rendered the professional liability coverage in the E&O policy illusory and the policy should be reformed to meet the insured's reasonable expectations in securing that coverage *i.e.,* insurance "designed to insure members of a particular professional group from liability arising out of the special risk such as negligence, omissions, mistakes and errors inherent in the practice of the profession." The court remanded the case to the district court to consider the question of the insured's reasonable expectations in securing the E&O coverage. *Crum & Forster Specialty Ins. Co. v. DVO, Inc.,* 2019 U.S. App. LEXIS 28714 (7th Cir. 2019).

Insured v. Insured Exclusion

Insured v. Insured Exclusion in Directors and Officers Policy is Ambiguous and does not Preclude Coverage

A New York trial-level court ruled that an insured v. insured exclusion in an excess directors and officers liability (D&O) policy was ambiguous concerning its applicability to claims by a creditor trust and therefore did not preclude coverage.

The insurer, an excess D&O insurer, requested dismissal of coverage claims based on the insured versus insured exclusion. The exclusion precludes coverage for claims brought by one insured against another insured under the policy. There is, however, a "carve-out" in the exclusion for claims brought by a bankruptcy trustee or examiner, receiver, conservator, liquidator "or other comparable authority." The parties disputed whether a creditor trust, established pursuant to a restructuring agreement in the bankruptcy proceedings, constitutes an "other comparable authority."

The insurer argued that the exclusion barred claims brought by a creditor trust established to gather and distribute creditor assets under the supervision of a three-member board, because such a trust is not "substantively independent and disinterested in the same way that a bankruptcy trustee or similar entity is and, consequently, is not a comparable authority." The insured argued that the term "comparable authority" is ambiguous and that, in any event, the creditor trust is the substantive equivalent of a creditor committee because it was established to obtain funds for insured's creditors, not the company.

The court explained that the insured versus insured exclusion is designed to prevent the company from recovering business loss that it could have avoided by more carefully supervising its own officers and directors. The court noted that this exclusion has exceptions for a bankruptcy trustee or a comparable authority, "since the funds recovered will be used for the benefit of creditors, rather than the company, and are subject to supervision by the bankruptcy court or a regulatory authority." The court determined the phrase "comparable authority" is not defined; that the phrase is ambiguous; and that the phrase must be construed in favor of the insured and against the insurer especially "because it is being invoked to exclude coverage."

The court ruled that the exclusion did not preclude coverage; denied the insurer's motion to dismiss; and directed the insurer to provide defense and indemnity to the insureds. *Westchester Fire Ins. Co. v. Schorsch*, 2019 N.Y. Misc. LEXIS 2085 (N.Y. Sup. Ct., N.Y. Cnty. 2019).

Insured v. Insured Exclusion Inapplicable without Evidence that Insured Directed Lawsuit be Filed

The United States District Court for the Central District of California decided that an insurer could not deny coverage under a directors and officers insurance policy (D&O) based on the policy's insured vs. insured exclusion ("I v. I exclusion") because there was no evidence that the insured directed that the suit be filed.

This coverage action arises out of the insurer's alleged breach of three directors' and officers' insurance policies (collectively, the "Policies") that were triggered in response to two underlying lawsuits brought against the insured and some of its officers or directors. The underlying lawsuits concerned disputes regarding a joint venture owned by two U.S. entities ("U.S. entities") and a foreign entity. The joint venture was formed to market and distribute in the United States, products manufactured by the foreign entity, including air conditioners and dehumidifiers.

The U.S. entities allegedly learned that dehumidifiers sold by the joint venture were catching fire and informed the foreign entity of these issues and told them that they would inform the Consumer Product Safety Commission and possibly issue a recall. The U.S. entities alleged that in response, the foreign entity engaged in a campaign to financially destroy them and the joint venture. The foreign entity counterclaimed, alleging misconduct in managing the joint venture. The foreign entity then filed a lawsuit in state court on its own behalf and derivatively on behalf of the joint venture against the U.S. entities and three directors of the joint venture, alleging new causes of action involving financial misconduct.

The insurer had issued three D&O policies: one to the joint venture, and one each to the U.S. entities. Other than the policy number and the identity of the named insureds, the three policies were identical. The insured reported the state action to its D&O insurer. The insurer initially defended the state action under the joint venture's policy, but then denied coverage and withdrew defense based on the Insured v. Insured exclusion, which excluded from coverage any Claim: brought or maintained by, on behalf of, in the right of, or at the direction of any Insured in any capacity, any Outside Entity or any person or entity that is an owner of or joint venture participant in any Subsidiary in any respect whether or not collusive, unless such Claim: ... is brought derivatively by a securities holder of the Parent Company and is instigated and continued totally independent of, and totally without the solicitation, assistance, active participation of, or intervention of, any insured...

The federal action proceeded to trial and resulted in a $42.5 million judgment for the U.S. entities. The parties ultimately reached a settlement that ended both the state and federal actions.

The U.S. entity insureds sued the insurer alleging wrongful coverage denial under the insured v. insured exclusion. The insurer argued that the state court action was necessarily filed at an insured's direction because the foreign entity's CEO was also a director of the joint venture. The court noted that the insurer's assumption that an insured had directed that the state action be filed was an "inferential leap," and that the insurer had not shown that the CEO was actually involved in the state action.

Applying California law, the court held that a genuine issue of material fact precluded summary judgment on the insureds' claim for bad faith. With respect to the U.S. entities' policies, the court found that the insurer breached its contractual obligations by failing to provide an immediate defense upon receiving notice of the state action. While the insurer did invite the insureds to tender a claim under the U.S. entities' policies, the insurer was duty-bound to do more and that an insurer must defend a suit which potentially seeks damages within the policy's coverage. The court noted that "[e]nough information was provided to the insurer such that it was made aware that the [U.S. entities'] Policies would potentially provide coverage" and that a jury may find that the insurer acted unreasonably in failing to provide a defense for over a year. *MJC Supply, LLC v. Scottsdale Ins. Co.,* 2019 U.S. Dist. LEXIS 94570 (C.D. Cal. 2019).

Insured v. Insured Exclusion Inapplicable in Dispute Between Co-Founders of Private Equity Firm

This coverage litigation arose of out a dispute between the two founders, the Chief Executive Officer ("CEO") and Chief Operating Officer ("COO"), of a private equity company. The CEO removed the COO from his position. This dispute was subsequently resolved in an arbitration of the COO's claims, which included wrongful termination, breach of fiduciary duty and negligence. The arbitration panel entered an award for the COO that was paid by the CEO and the company.

The primary and excess insurers initially denied coverage. After two mediations, the primary and first excess insurers agreed to make certain payments under their respective policies. The second excess insurer continued to deny coverage and the insured filed suit for breach of contract, insurance code violations and bad faith. The insurer responded that the insured failed to exhaust the underlying policies and asserted affirmative defenses based upon the insured v. insured exclusion, the dishonesty exclusion, and the allocation provision.

The court determined that, "although an Insured v. Insured relationship exists here, the Wrongful Employment Practices exception negates the I v I exclusion as a global defense to [the insured's] contract breach cause of action." The insurer argued that the policy's "unambiguous Insured v. Insured exclusion operates to sweep the entire underlying arbitration outside of coverage." The insured countered that the insurer's global insured v. insured defense "is wrong because the exception to the Insured versus Insured exclusion applies to the entire Claim here ... and therefore the Insured versus Insured exclusion is inapplicable."

The court agreed and concluded that the COO's claim began when he sent his demand letter to the CEO referencing his wrongful termination and that "one reasonable Policy reading is that it treats the entire arbitration rooted in [the COO's] termination as a single Claim beginning with [the COO's] initial demand letter."

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The insurer also relied on the dishonesty exclusion to deny coverage. The dishonesty exclusion applies to "any deliberately dishonest, fraudulent, or criminal act or omission committed with the willful intent to deceive, or any personal profit or advantage gained by any Insured to which they were not legally entitled." The exclusion requires that such conduct must be established by a final adjudication. The court concluded that there was no finding or explanation regarding the arbitration panel's award and that "the exclusion requires that a final adjudication establish one of these enumerated types of conduct. This term requires a specific judgment or similarly express adjudication that the excluded conduct was the actual cause of damages. There is no such adjudication here." Accordingly, the excess insurer was liable to the insured for the balance of the award and defense fees remaining after payments by the primary and first excess insurers. *Prophet Equity LP v. Twin City Fire Ins. Co.,* 2019 Tex. App. LEXIS 7302 (5th Dist. 2019).

Professional Services Exclusion

Professional Services and other Exclusions Interpreted Narrowly in Favor of Insured

The insured, an investment manager, was sued on behalf of a pension fund for allegedly mismanaging and squandering the pension funds' investments. The suit alleged claims for negligence and violations of the Employee Retirement Income Security Act of 1974 ("ERISA"). The first count alleged that the insured was negligent in overleveraging its investment into a residential condominium, a hotel, and a housing development ("Properties"), failing to pay property taxes, and retaining income from the Properties for its own use. The second count alleged that through the insured's retention of revenues from one of the properties, the insured took on fiduciary duties to the pension fund, which it subsequently violated through "self-dealing and mismanagement..."

When the insurer was notified of the claim, it advised the insured that the claims were excluded from coverage based upon the ERISA and Professional Services exclusions in the policy. The insurer refused to defend or indemnify the insured. The lower court found that the allegations in the underlying action were not "clearly excluded" under the policy and that the insurer, at a minimum, owed a duty to defend. The insurer appealed and argued that it did not have a duty to defend based upon the Professional Services Exclusion and the ERISA Exclusion, but alternatively, should only be liable for the cost of defending the underlying action because the claims were also excluded by the policy's Conduct Exclusion.

The First Circuit agreed with the lower court, finding that the Professional Services and ERISA Exclusions did not bar the insurer's duty to defend. As an initial matter, the court noted that "'[i]n order for the duty of defense to arise, the underlying complaint need only show, through general allegations, a possibility that the liability claim falls within the insurance coverage. There is no requirement that the facts alleged in the complaint specifically and unequivocally make out a claim within the coverage.'" The insurer bears the burden of establishing that the exclusions apply.

The insurer argued that all the allegations in the underlying action "arose out of" or "involved" "real estate development, property management, the purchase of real property, or the arranging of financing on real property," and are excluded by the Professional Services Exclusion. The court found that the Professional Services Exclusion did not apply, as written, because the allegations in the underlying complaint, with respect to two of the three properties, alleged simply that the insured had invested in the two properties and they were "lost to foreclosure or written down to a zero value because of tax or mortgages owed" and that the insured "engaged in self-dealing by retaining investment income from the properties for its own use." Therefore, the "limited allegations preclude any meaningful evaluation of whether the loss of the [properties] was attributable to [the insured's] actions as a property manager, developer, investor, or otherwise." The court noted that allegations created ambiguity that all the alleged conduct stemmed from the insured's professional services, "and, where there is ambiguity, there is a duty to defend."

Moreover, the court rejected the insurer's argument that the ERISA Exclusion extended to the negligence cause of action. In noting that the insurer bears the burden of demonstrating the exclusion's applicability, the court concluded that the exclusion was ambiguous as to whether it extended to a common law action for negligence that did not specifically allege ERISA-like fiduciary duties. Accordingly, the court did not see a basis to relieve the insurer of its obligation to pay the policy limit. *Scottsdale Ins. Co. v. Byrne*, 2019 U.S. App. LEXIS 1440 (1st Cir. 2019).

Privacy Exclusion

Coverage for TCPA Lawsuit Excluded Under D&O Policy

The United States District Court for the Southern District of Florida ruled an insurer was not obligated to defend or indemnify its insured in a suit alleging violation of the Telephone Communication Protection Act (TCPA). The court held, in part, that coverage was excluded by the broad language for claims which "arise out of" an invasion of privacy and that violation of the TCPA, in this instance, was a violation of privacy.

In the underlying class action suit, plaintiffs alleged that a "national direct response marketer and seller of insurance products" had "violated the TCPA by sending autodialed text messages to consumers' cellular telephones when those consumers had not previously consented to receive such messages or [had] registered their telephone numbers on the national do-not-call registry." The underlying complaint alleged the insured had caused consumers harm which included "invasions of privacy, aggravation, annoyance, nuisance and a loss of value realized for the monies consumers paid to their carriers for the receipt of such text messages and a loss of the use and enjoyment of their phone." The insured tendered the original and amended class action complaints to its directors and officers liability carrier, which denied coverage, citing the invasion of privacy exclusion. The TCPA parties subsequently reached a settlement and entered a significant consent judgment. The class plaintiffs agreed to pursue recovery against the insurer and brought a coverage action for declaratory judgment and breach of contract.

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The insurer maintained the invasion of privacy exclusion and other provisions of the policy precluded coverage in its entirety. In considering the arguments presented by the parties, the court commenced its analysis by examining whether a violation of the TCPA constituted an invasion of privacy, even though, as pointed out by the plaintiffs, an invasion of privacy is not an element of the TCPA. The court found that "a violation of the TCPA may in some circumstances be considered an invasion of privacy for the purposes of analyzing coverage in an insurance policy." The court examined other opinions which similarly addressed the TCPA and its relation to invasion of privacy, including, i) a Florida Supreme Court decision which recognized a nexus between the TCPA and invasion of privacy, ii) a persuasive Ninth Circuit decision which held that "a TCPA claim is inherently an invasion of privacy claim" and iii) an Eighth Circuit decision which concluded that "it is clear that Congress viewed violations of the Act as 'private nuisances' and as 'invasions of privacy' under ordinary, lay meaning of these phrases." The court also found significant that the policy excluded claims that "arise out of"' an invasion of privacy meaning "'originating from,' 'having its origin in,' 'growing out of,' 'flowing from,' 'incident to' or 'having a connection with'" allegations of invasion of privacy. Based on allegations in the underlying complaint, the court concluded that "such a nexus does exist" in this case. The court did not determine whether "TCPA violations are per se invasions of privacy, but instead concludes that on the facts before this court, the Invasion of Privacy Exclusion would apply." The court also concluded that all the underlying causes of action arose out of the TCPA violations and were similarly excluded from coverage. *Horn v. Liberty Insurance Underwriters, Inc.* 2019 U.S. Dist. LEXIS 90194 (USDC S.D. Fla. 2019).

Profit Exclusion

Claw Back Claim not a Wrongful Act and Subject to the Profit and Advantage Exclusion

The United States District Court for the Middle District of Florida, applying Florida law, granted summary judgment to an insurer ruling that a D&O policy ("Policy") did not provide coverage to a former director and officer for a claim ("Claw Back Claim") made by a Florida government agency (the "agency") for the return of bonus and other compensation amounts ("Claw Back Payment") paid within a year of commencement of delinquency proceedings against the insured company.

The insurer asserted there was no coverage because (i) the profit or advantage exclusion applied to the facts and circumstances and (ii) the Claw Back Claim was not a claim for a "Wrongful Act" within the meaning of the relevant Policy language. The Policy's profit or advantage exclusion barred coverage for Loss arising out of "the gaining of any profit or advantage to which an Insured was not legally entitled" as established by "a judgment or other final adjudication" against the insured. The Policy defined "Wrongful Act" as "any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty" by an Insured Person or the Insured Organization. The insured argued that the profit or advantage exclusion was inapplicable, and the Claw Back Payment constituted a Wrongful Act.

In ruling on the motions for summary judgment, the court held that the profit or advantage exclusion applied because the insured was not legally entitled to the Claw Back Payment after the agency voided the transfer and demanded repayment. It also held that the trial court's grant of "summary final judgment" to return the Claw Back Payment was a "judgment or other final adjudication" against the insured sufficient to trigger the profit or advantage exclusion. [Ed. Perhaps the outcome on this exclusion would be different if it required "final non-appealable" judgment or adjudication.]

Next, the court held that the Claw Back Claim was not a claim for a "Wrongful Act" within the meaning of the Policy because the claim was not triggered by any act, error or omission by the insured person or the insured company. Rather, the agency asserted the Claw Back Claim because the Claw Back Payment was made within a year of commencement of delinquency proceedings against the insured company, thus making the payments voidable under Florida law. The court ruled that there was not "act, error, omission, misstatement, misleading statement, neglect or breach of duty" by the insured or the insured company "that triggered the claim." The court noted that "under the plain language of the policy, the agency Claw Back Claim was not a claim for a 'Wrongful Act' and the policy does not provide coverage." *Desai v. Navigators Ins. Co.,* 2019 U.S. Dist. LEXIS 115897 (M.D. Fla. 2019).

Prior Notice Exclusion

Seventh Circuit Court of Appeals Vacates Decision for Insurer that had been based on Prior Notice Exclusion

In an unusual decision on a petition for rehearing, the United States Court of Appeals for the Seventh Circuit vacated its prior opinion that had tentatively reversed a district court decision in favor of the insured.

The underlying case involved the insured's simultaneous notice of a shareholder lawsuit to two separate insurers, which were on the risk for two separate policy periods - 2009-2010 and 2011-2012. The insurer for the 2011-2012 policy denied coverage based upon a policy exclusion "for Loss in connection with... 'Event(s)'", which included "[a]ll notice of claims or circumstances as reported under [the 2009-2010 policy] issued to [the insured]...". That insurer denied coverage as notice had also been provided to the insurer under the 2009-2010 policy. The insured instituted proceedings against the 2011-2012 insurer, alleging breach of contract and breach of the duty of good faith and fair dealing. The insurer argued that the policy excluded Claims where a notice had been reported to the prior insurer at any time while the insured argued that the policy provision excluded only notices that had been reported at the time the policy went into effect.

The district court concluded that both of the interpretations were reasonable but found that the past tense 'as reported' language within the exclusion must "refer[]to events that had already occurred at the time of drafting", thereby agreeing with the insureds that the exclusion should not apply because the claims were not reported prior to the inception of the 2011-2012 policy.

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However, on appeal, the Seventh Circuit found that the phrase 'as reported' had no discernable temporal limitation and once the insured reported a claim (regardless of timing) the claim is "reported" and was therefore excluded. Subsequently, the Seventh Circuit opinion was vacated, resulting in affirmation of the district court's decision in favor of the insured that the exclusion was inapplicable. *Emmis Comm. Corp. v. Ill. Nat'l Ins. Co.,* 2019 U.S. App. LEXIS 24930 (7th Cir. 2019).

Securities Exclusion

Securities Exclusion Precludes Insurer's Duty to Defend and Indemnify Insureds

The United States District Court for the Middle District of Florida ruled that an exclusion for claims arising from the purchase or sale of securities precluded coverage under a private company Directors' & Officers' Liability policy.

In the underlying lawsuit, the plaintiffs alleged that the insured entity and certain of its directors and officers made misrepresentations and omissions of material fact concerning their purchase of company shares from the plaintiffs that drove down the share price. The plaintiffs sued and alleged several different legal theories. The underlying lawsuit was submitted to the company's insurer under its D&O policy. The insurer denied coverage pursuant to the securities exclusion contained in the policy.

In considering the insurer's motion to dismiss, the court stated that "when an insurer relies on an exclusion to deny coverage, it has the burden of demonstrating that the allegations of the complaint are cast solely within the policy exclusion and are subject to no other reasonable interpretation" and that "insurance coverage must be construed broadly and its exclusions narrowly."

The court observed that the securities exclusion eliminates coverage for claims "based upon, arising out of or in any way involving ...the actual, alleged or attempted purchase or sale, or offer or solicitation of an offer to purchase or sell, any debt or equity securities." The court remarked that the phrase "arising out of" is unambiguous and means, among others, "having a connection with." Similarly, the court remarked that "the phrase 'or in any way involving' is broad as a term of regular English usage, and courts have so noted." Therefore, if the claims the insureds sought coverage for "in any way" involve security sales then the exclusion applies.

The court explained that the underlying lawsuit involves and arises from security sales and after performing an individual analysis of the seven counts in the complaint stated the "entire complaint seeks to revoke, rescind, or get damages for the sale of stock in [the company]." Thus, the insurer met it burden to demonstrate that all the counts in the underlying lawsuit fall within the exclusion.

Consequently, the court ruled that the underlying lawsuit triggered the broad securities exclusion and the insurer had no duty to defend or indemnify the insureds. *Colorado Boxed Beef Co. v. Evanston Ins. Co.*, 2018 U.S. Dist. LEXIS 217936 (M.D. Fla. 2019).

Specific Matter Exclusion

Specific Matter Exclusion Bars Five Lawsuits

The United States Court of Appeals for the Ninth Circuit affirmed a lower court's ruling that a specific matter exclusion barred coverage for several lawsuits brought against an insured, a housing corporation. The insured faced a series of lawsuits brought by banks, and the directors and officers were also sued separately in a derivative action. The bank cases involved an alleged scheme to extinguish the bank's security interests, in which the insured would transfer those interests to relatives to avoid the bank's security interest in the properties.

The insurer issued two successive claims made directors and officers liability policies to the insured under which the insured tendered five independent lawsuits. Ultimately, the insurer denied coverage and a defense obligation based upon a specific matter exclusion in both policies. Subsequently, the insured filed a declaratory judgment action. The district court concluded that the specific matter exclusion in the policies barred potential coverage of any claim in the five underlying lawsuits. The court found that the cases all shared the same general narrative, actors and overall scheme.

On appeal, the appellate court agreed with the district court finding that the allegations in the complaints fell within the specific matter exclusions in the policies. The court noted that "[t]he Specific Matter Exclusion is very broad, excepting from coverage ' Loss on account of any Claim based upon, arising from, or in consequence of any fact, circumstance or situation underlying or alleged in any Specific Matter or any substantially similar fact, circumstance or situation.'" The court, relying on the broad language of the exclusion, found that all of the claims asserted in the five tendered lawsuits were barred. *Ocean Towers Hous. Corp. v. Evanston Ins. Co*., 2019 U.S. App. LEXIS 17971 (9th Cir. 2019).

Specific Litigation Exclusion in Directors' and Officers' Liability Policy Barred Coverage for Subsequent Interrelated Claims

The United States Court of Appeals for the First Circuit held that the insureds were not entitled to coverage for a series of lawsuits, regulatory investigations and arbitrations ("the disputed matters") based upon a broadly worded specific litigation exclusion, because the matters all involved facts, situations or circumstances alleged in the prior claims listed in the exclusion.

The insured had filed suit against its primary and excess insurers alleging that the insurers breached the insurance contract by refusing to provide coverage for the various claims submitted for coverage. The insured was the subject of a Securities and Exchange Commission ("SEC") investigation and a derivative lawsuit ("the prior matters") before purchasing directors' and officers' liability insurance with its then current insurers. The primary and excess policies included a specific litigation exclusion for the prior matters. The exclusion precluded coverage for "any Claim in connection with any proceeding set forth below, or in connection with any Claim based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any such proceeding underlying or alleged therein." The policy also contained an interrelated claims provision "mandating that

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all claims resulting from interrelated wrongful acts constitute a single claim." In addition, notice of claims must be provided in writing "as soon as practicable after it is first made... but in no event later than ninety (90) days after the expiration of the Policy Period."

When the insured sought coverage for the disputed matters, the primary insurer denied coverage citing the specific litigation exclusion. The insurer argued that the disputed matters were related to the prior matters and that some of the matters arose after the policy period ended. The insured argued that the insurer was interpreting the specific litigation exclusion too broadly and that it only applies when there is "substantial overlap." The insured further argued that the matters that arose after the policy period ended should be covered because they were interrelated to the claims that arose during the policy period.

The appellate court determined that "[a]lthough the language is undoubtedly broad, it was the language [the insured] bargained for. Indeed, as previously alluded to, during negotiations [the insured] attempted to narrow the scope of the Specific Litigation Exclusion, but [the insurer] rejected the proposed changes." The insured attempted to replace "any fact, circumstance or situation underlying or alleged therein" with "the same Wrongful Act alleged in such proceeding," and to remove the phrase " in any way." The court noted that despite the insurer's rejection of the insured's proposed changes, the insured purchased the policy. In addition, the insured argued that the exclusion does not apply "on a proceeding-to-proceeding basis or complaint-to-complaint basis, but rather an 'act-to-act' basis," therefore, only a portion of a proceeding would be excluded. While the court described the insured's argument as "ingenious," it did not find that the argument was supported by the intent of the parties. The First Circuit "has recognized that the phrase 'in any way involving' should be expansively read." Accordingly, the court held that "we must enforce the policy according to the terms agreed to by the parties to this appeal. We thus find that the Specific Litigation Exclusion bars coverage of the Disputed Matters, as they all involve 'fact[s], circumstance[s], or situation[s]' alleged or underlying [the prior matters]." *UBS Fin. Servs. v. XL Specialty Ins. Co.,* 2019 U.S. App. LEXIS 19946 (1st Cir. 2019).

Wage & Hour Exclusion

Wage and Hour Exclusion Applies Narrowly

The Court of Appeals for the State of California held that a wage and hour exclusion in the insured's employment practices liability ("EPL") policy should have been applied more narrowly and the underlying complaint did trigger EPL coverage.

The insured owned and operated over 250 restaurants. It was named in a putative class action alleging violations of a variety of Labor Code provisions, as well as failure to timely pay earned wages upon discharge, failure to timely pay earned wages upon resignation, unfair business practices, and recovery of civil penalties under a private attorney general theory. The insured sought coverage under its EPL policy. The policy, while covering "Inappropriate Employment Conduct" as that term was defined, excluded, as with many EPL policies, violations of the wage and hour laws. The policy's "wage and hour" exclusion stated: "[t]his Policy does not cover any Loss resulting from any Claim based upon, arising out of, directly or indirectly connected or related to, or in any way alleging violation(s) of any foreign, federal, state, or local, wage and hour or overtime law(s), including, without limitation, the Fair Labor Standards [Act]." The insurer disclaimed coverage save for a sublimit for defense costs.

The court undertook an analysis and interpretation of the ordinary meaning of "wage and hour...laws" as it was not defined in the policy. The court reasoned that "using the ordinary meaning of the words, the phrase 'wage and hour...law' refers to laws concerning duration worked and/or remuneration received in exchange for work." As to the claims for which the insured sought additional coverage, the court determined that relative to the wage statement requirements found in Labor Code Section 226, this was "a quintessential wage law" and that "[t]he Legislature enacted the section as part of a comprehensive statutory scheme governing the payment of wages." Coverage was therefore precluded by the wage and hour exclusion. However, as to the allegations regarding the insured's failure to reimburse business-related travel expenses required for training, mileage driven for deliveries and cell phone usage, the court determined that these allegations were not precluded from coverage. The court analyzed California Labor Code Statutes 2800 and 2802 requiring "an employer to indemnify its employee for certain losses or expenditures under specified circumstances" and that "an employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties." The court noted that neither statute mentioned "wages." The court also determined that failing to reimburse employee expenses "qualified as an employment-related workplace tort."

The court also concluded that the claims seeking relief under section 17200 and the Private Attorneys General Act are derivative claims based, in part, on defendant's alleged failure to reimburse business related expenses, and to the extent potentially within the scope of the Policy, are not excluded." *Southern California Pizza Co., LLC v. Certain Underwriters at Lloyds, etc.,* 2019 Cal. App. LEXIS 900 (Cal. App. 4th 2019).

Part III: General Insurance Provisions

Application Issues

Insured not Required to Disclose Claim on Application where it did not Assert Wrongful Acts

The United States Court of Appeals for the Ninth Circuit recently found that an insured real estate investment and development firm was not obligated to disclose an investor demand letter on its directors and officers insurance (D&O) policy application because the letter did not assert any wrongful acts.

The insured received a demand letter from an investor reminding it that payments for promissory notes were due and included a warning that the investor "would like to try not to proceed with legal remedy." The letter did not allege any misconduct by the insured.

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Subsequently, the insured applied for a D&O policy. The insured then received a second demand letter from the investor warning that it may file claims for breach of contract, breach of fiduciary duties, fraud and securities fraud against the insured. The insured contacted the insurer which agreed to provide a defense, subject to a reservation of rights. The insurer was unaware of the first demand letter.

The investor provided a draft complaint to the insured, which the investor subsequently filed several months later. Both complaints mentioned the first demand letter. After reviewing the draft complaint, the insurer denied coverage and reaffirmed its denial upon review of the filed complaint. The insured settled with the investor and filed suit against its insurer for breach of contract and negligence, alleging that the insurer had a duty to defend it in the underlying action. The lower court concluded that the first demand letter was a claim first made before the policy incepted and, therefore, the insurer did not have a duty to defend or indemnify the insured for the claim. On appeal, the insurer argued that the insured made a material misrepresentation in the insurance application.

In determining whether the insurer had an obligation to provide coverage, the Ninth Circuit looked at the policy's language, which provides indemnification for losses "arising from a Claim first made during the Policy Period ... against such Insured Person for any Wrongful Act ..." Wrongful Act is defined as "any actual or alleged act, error, omission, neglect, breach of duty, breach of trust, misstatement, or misleading statement by [the insureds]." The court concluded that, based upon the clear policy language, the first demand letter that the insured received prior to obtaining the policy, did not constitute a claim for a "wrongful act." The court added that if the insurer "obtains evidence of... material misrepresentations that predate the Policy, then [the insurer] could potentially establish an entitlement to equitable reformation of the contract to exclude any claim made by [the investor]." *Kelly v. Starr Indem. & Liab. Co.*, 2019 U.S. App. LEXIS 12871 (9th Cir. 2019).

Response to Prior Knowledge Provision of Insurance Application Precludes Coverage

The United States District Court for the Eastern District of Pennsylvania ruled that the plaintiffs' failure to provide information with respect to the prior knowledge provision of the insurance application form precluded coverage under a professional liability policy.

The insured, a law firm, represented an electrician ("client"), who sustained personal injuries while working at a private residence. The client received workers' compensation benefits from the workers' compensation insurer. The plaintiffs, on behalf of the client, commenced a personal injury lawsuit against the homeowner. They received a settlement offer and resolved the subrogation lien for workers' compensation benefits. However, the plaintiffs accepted the settlement offer on behalf of the client without obtaining an express written waiver of the credit for future benefits, as required by statute, from the worker's compensation insurer.

Subsequently, the worker's compensation insurer moved the worker's compensation review board for a credit for future workers' compensation benefits due the client. The review board granted the request for the credit and in the written decision harshly criticized the plaintiffs' role in the settlement and the failure to obtain an express waiver of the credit.

Thereafter, the plaintiffs submitted an application for a professional liability insurance policy. The plaintiffs responded "no" to the question on the application form: "[i]s the applicant or attorney for whom coverage is sought aware of any act, error, omission or incident that might reasonably be expected to result in a claim or suit being made against them?"

The insurer approved the application and issued the professional liability insurance policy. Notably, the professional liability insurance policy included a provision that stated coverage would be provided only if: "[p]rior to the inception of this Policy, no Insured knew or should have known that the same or related wrongful act, legal services, fact, circumstance or adverse outcome might give rise to a claim." The law firm was subsequently sued for legal malpractice by the client. The insurer denied coverage based upon the prior knowledge provision of the policy.

The court considered whether "[the law firm was] required to disclose on the insurance application form the possibility of a claim or lawsuit against them from the [client]." The court applied Pennsylvania's two-step analysis for considering a prior knowledge provision in an insurance policy: "[t]he first step is a subjective evaluation in which the court determines what facts the insured actually knew prior to the effective date of the policy. The second step is an objective determination which incorporates the language of the policy and asks whether a reasonable attorney equipped with the facts known to the insured would have reason to know that a claim or suit might be made against him."

The court explained that the law firm actually knew prior to the effective date of the professional liability insurance policy that: they settled the underlying personal injury lawsuit; they did not obtain an express written waiver of the credit for future benefits as required by statute; the client believed the law firm obtained an express written waiver of the credit for future benefits; the client believed he would be eligible to receive future worker's compensation benefits without application of a credit; according to the law firm, the client was "getting royally screwed"; the worker's compensation review board ruled that the law firm was clearly to blame for not obtaining the credit waiver and the resulting harm to the client; and the client requested a copy of his file which according to the law firm could mean that "they're upset about something." Considering the second objective step of the analysis, the court concluded that taking into account the facts known by the law firm a reasonable attorney would have reason to know that a claim or suit might be brought. The court stated that the decision of the workers' compensation review board alone, which solely fixes blame for the financial damage to the client on the law firm, "is certainly a strong indicator that the attorney's action might give rise to a claim for legal

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malpractice." Importantly, the court ruled that the lawyer's "subjective belief based upon his relationship with his client, that the client would not bring a malpractice suit, is irrelevant to this objective analysis."

Consequently, the court ruled that the insurer had no obligation to defend the law firm because of the failure to provide information under the prior knowledge provision of the insurance application form. *Zavodnick, Zavodnick & Lasky, LLC v. Nat'l Liab. & Fire Ins. Co.*, 2019 U.S. Dist. LEXIS 33173 (E.D. Pa. 2019).

Application Misrepresentation Precludes Coverage

A federal district court, in denying coverage to a company under a business and management liability policy, held that an insured made material misrepresentations in its policy application regarding contemplated acquisitions. The technology company applied for a business management and liability policy. The application asked, "[d]oes the Company contemplate transacting any mergers or acquisitions within the next 12 months?" Despite the company's general counsel answering "No" to the acquisition warranty question, the company had been in discussions with a business partner about a possible acquisition for several months.

Shortly after the policy incepted, the insured was acquired by its business partner and encountered litigation and government investigations that alleged misrepresentations made in connection with the acquisition. While the insurer provisionally reimbursed defense costs, it reserved its right to deny coverage and seek reimbursement. The insurer later filed suit to recoup the amounts paid under the policy on the theory that the policy application contained a material misrepresentation.

The court determined that the word "contemplate" was only subject to one interpretation. The court rejected the company's interpretation and reasoning that the application question at issue could only be interpreted as referring to a formal acquisition offer – which, as the company argued, had not occurred at the time the application was executed. The company's answer to the application question was inaccurate because, as the court concluded, the question encompassed more than formal acquisition offers. The court also determined such a misrepresentation was material. *Scottsdale Ins. Co. v. CSC Agility Platform, Inc.*, 2019 U.S. Dist. LEXIS 62985 (C.D. Cal. 2019).

Bankruptcy

Settlement Blocking Former Bank Employees' Claims to D&O Policy Proceeds Overturned

The United States Court of Appeals for the Fifth Circuit held that the district court abused its discretion in approving a settlement and related bar orders in litigation arising out of a bank Ponzi scheme by extinguishing the insured persons' claims to the policy proceeds, while making no provision for them to access the proceeds through the bank receiver's claims process.

A Securities and Exchange Commission's (SEC) lawsuit against the insured debtor involved a Ponzi scheme that defrauded more than 18,000 investors who collectively lost over $5 billion. As part of the SEC securities fraud lawsuit, the district court appointed a receiver "to immediately take and have complete and exclusive control" of the receivership estate and "any assets traceable" to it. The court granted the receiver "the full power of an equity receiver under common law," including the right to assert claims against third parties and "persons or entities who received assets or records traceable to the Receivership Estate."

The policies issued to the bank entities covered losses and defense costs for the entities and their officers, directors and certain employees, and included a directors' and officers' liability and company indemnity ("D&O") policy and an excess policy.

The receiver also pursued the policy proceeds indirectly by filing lawsuits (the "Indirect Claims") against hundreds of former bank directors, officers, and employees, alleging fraudulent transfers and unjust enrichment and/or breach of fiduciary duty. The receiver obtained a $2 billion judgment against one former bank director and a $57 million judgment against a former bank treasurer, both of whom were potentially covered under the policies. The receiver continues to litigate similar claims against the other insured individuals who were bank managers and employees.

The receiver and various insurers, together with the court-appointed examiner on behalf of the bank's investors, mediated their disputes, which initially resulted in a settlement proposal under which the insurers agreed to pay the receiver $65 million, and in return the receiver would "fully release any and all insureds under the relevant policies." The purpose of the complete release was to shield the insurers from any policy obligations to defend or indemnify former bank personnel in the receiver's Indirect Claim lawsuits. The settlement included "bar orders," that eliminated the individuals' claims to the policy proceeds and their extracontractual claims against the insurers, even if such claims would not reduce or affect the policies' coverage limits. The individuals challenged the district court's approval of a global settlement between the receiver and insurers.

The Fifth Circuit found that "not only did the settlement expressly foreclose the Appellants from sharing in the insurance policy proceeds of which they are coinsureds, the Appellants are not even allowed to file claims against the Receivership estate," which "undermines the fairness of the settlement." The court noted that "[t]he district court and Receiver lacked authority to dispossess claimants of their legal rights to share in receivership assets "for the sake of the greater good." The Fifth Circuit reversed the lower court's orders approving the settlement and bar orders, and remanded the matter for further proceedings. *SEC v. Stanford Int'l Bank, Ltd.*, 2019 U.S. App. LEXIS 18111 (5th Cir. 2019).

California Ins. Code Section 533

Ninth Circuit Holds Section 533 Does not Bar Coverage for Alleged Willful Acts in Mortgage Modification Scam

The Ninth Circuit Court of Appeals, applying California law, held that a lawsuit for "personal and advertising injury" is insurable under a general liability insurance policy and that an insurer improperly failed to defend the insured.

In the underlying suit, the plaintiff alleged that its claims arose from the insureds' fraudulent mortgage modification scam targeting vulnerable homeowners seeking

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mortgage modifications. The complaint further alleged that the insureds made false statements that referred to the underlying plaintiff's business and derogated the plaintiff by, *inter alia*, making people believe that the plaintiff was being deceptive. The underlying plaintiff claimed that, as a result of those statements, it suffered damages to its reputation and goodwill.

The insurer denied coverage and refused to defend the insured on the ground that claims did not trigger coverage. The insured settled the underlying suit and then sued the insurer. The district court granted summary judgment to the insurer based on several exclusions and because Section 533 of California's Insurance Code bars coverage for the insured's willful acts. The district court stated that:

The California supreme court has interpreted [Section 533] to mean insurers aren't liable for inherently harmful acts. The insured doesn't have to subjectively desire to cause harm for an act to be inherently harmful. Instead, an act is inherently harmful and considered a "willful act" under Section 533 so long as there was "a deliberate, liability-producing act that the individual, before acting, expected to cause harm. [Citations omitted.]

The Ninth Circuit reversed the lower court's ruling and found that because at least the Lanham Act trademark infringement claim in the underlying complaint against the appellants did not require a showing of willfulness within the ambit of Section 533 to impose liability, there was a sufficient "potential for liability" to trigger the insurer's broad duty to defend under California law. The court noted that not every claim in the complaint was so "inseparably intertwined" with willful conduct as to render the entire action uninsurable. *First One Lending Corp. v. Hartford Cas. Ins. Co.*, 2019 U.S. App. LEXIS 6625 (9th Cir. 2019).

Duty to Defend

Summary Judgment Precluded Over Insurer's Failure to Provide Immediate Defense

This coverage action was filed by a nonprofit public benefit corporation against their directors and officers ("D&O") insurer arising out of its alleged failure to provide an immediate defense to the insured and one of its directors in an investigation by the United States Attorney's Office ("USAO"). It was undisputed that the insurer was obligated to defend the insured as well as individual insureds under the policy.

After the USAO launched an investigation into the insured focusing on the theft of government property and following the issuance of warrants to search the insured's records, the insured sought consent of its insurer of its selection of defense counsel; however, the insurer one month later, rejected the insured's assignment of defense counsel and appointed a different firm. In response, the insured objected to the insurer's appointment of counsel.

Thereafter, the USAO named one of the insured's board members as a "person of interest." The USAO advised the insured that there may be a conflict of interest preventing the insured's chosen firm from representing the insured and some of the directors and officers. The insured then notified the insurer that the individuals identified as "persons of interest" requested a defense. The insurer denied the insured's request for separate counsel to be appointed for the individuals and advised that the insured had not identified conflicts of interest between the insured and the board members or between the board members individually.

The insured filed suit against the insurer alleging, among other things, breach of contract due to the insurer's failure to pay defense fees incurred between tender and acceptance of a defense; failure to reimburse the insured for defense fees incurred prior to the insured's tender of the claim; and failure to assign separate counsel to a "person of interest" sooner or reimburse the insured for the fees incurred as a result of the insurer's delay.

After noting that it was well settled that "the duty to defend arises as soon as tender is made...," the court found that the insurer's month-long delay in accepting its obligation to defend after being notified of the search warrant could constitute a breach of the policy in light of the "high-profile and high stakes nature" of the investigation. The court also found that the insurer did not breach the policy by refusing to reimburse the corporation for its pre-tender fees. In this regard, the insured argued that it was required to immediately hire counsel in response to the warrants, and that the costs it incurred before notifying the insurer were therefore involuntary. The court found otherwise, noting that the insured failed to produce evidence establishing why it was unable to immediately notify the insurer of the investigation. Moreover, the court held that factual issues precluded summary judgment as to whether the insurer should have appointed separate counsel sooner, and if so, whether the insurer engaged in "bad faith" as a result. *Celerity Educ. Grp. v. Scottsdale Ins. Co.*, 2019 U.S. Dist. LEXIS 17744 (C.D. Cal. 2019).

Policy Interpretation

Eight Corners Rule Requires Insurer to Defend in Social Engineering Scam

A Texas federal court found that, after a hacker impersonating a customer convinced the insured to wire $1 million out of the customer's account, the insurer had a duty to defend its insured against claims by its customer because the potential for coverage existed.

The case arose after the insured received fraudulent wiring instructions from an individual purporting to be one of the insured's clients. Relying upon the erroneous instructions, the insured wired $1 million from the client's account to a bank account controlled by the fraudster. Following the erroneous transfer and the inability to recover the funds, the client sent a formal demand letter to the insured seeking compensation for the loss, citing the insured's "failure to employ proper controls and failure to take reasonable care in safeguarding the [client's] assets." The insured sought coverage and a defense under its Directors and Officers Liability and fidelity coverage insurance. The claim was denied.

As a result, the insured settled the underlying claim with its customer and sued the insurer. The court applied an exception to the "eight corners rule" to look beyond the four corners of the demand letter and the four corners of the policy, and found factual issues existed

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based upon extrinsic evidence. On reconsideration, the court held that its prior ruling was in error. Applying the eight corners rule, the court determined that the exclusions relied upon by the insurer in denying coverage (*e.g.* the contract exclusion) was indeterminable from the face of the demand letter. As a result, the court found that the possibility of coverage existed, and therefore triggered the insurer's duty to defend as a matter of law. *Quality Sausage Company, LLC v. Twin City Fire Ins. Co.,* No. 4:17-CV-111 (S.D. Tex., Sept. 18, 2019).

Public Policy

Florida Public Policy Precludes Coverage for Voluntary Settlement of Criminal Charges

A criminal investigation determined that an insurance agency and its chief executive officer obtained over $416,000 from a customer by creating fraudulent invoices with inflated premiums. A portion was taken within the statute of limitations period and the insureds were criminally charged with grand theft. They settled with the state which required a repayment to the customer ("Payment"); a $100,000 donation to a charity ("Donation"); and a $20,000 payment to the governmental agency for the cost of the investigation ("Investigation Costs").

The agency's D&O insurer refused to indemnify the insureds for the settlement and filed suit for a declaration that the settlement amounts were not covered under the D&O policy. The district court held that as a matter of Florida law, insurance contracts do not insure the restitution of ill-gotten gains and the settlement amounts were "clearly restitutionary in nature." The appellate court affirmed the district court's ruling, stating that as a matter of Florida law, an insurance policy excludes the restitution of ill-gotten gains because it could encourage commission of wrongful acts and compensate the wrongdoer. Therefore, the Payment and Investigative Costs were not covered under the D&O policy because of their restitutionary nature. As to the Donation, the court ruled it was a penalty and not covered Loss under the D&O policy.

In concluding that the Payment was restitution of ill-gotten gains and not covered under the policy, the court of appeals noted that it was nearly identical to the amount of the insureds ill-gotten gains that fell within the statute of limitations period and was made to make the customer whole for its losses. The court stated that an admission of guilt from the wrongdoer is not required for a payment to be the return of an ill-gotten gain because if a determination of guilt was required, wrongdoers would be encouraged to enter into settlements, never technically admit their guilt, and recoup the proceeds of their wrongdoing through their insurance providers. Further the court ruled that the final judgment provision in the D&O policy exclusion for ill-gotten gains is not relevant until there is coverage in the first instance and, as a matter of Florida law, insurance contracts are not permitted to insure the restitution of ill-gotten gains so there is no need to look to the exclusion. The court concluded for the same reasoning that the Investigation Costs also constituted restitution and were not covered under the D&O policy.

As to the Donation, the court determined that it was a penalty and therefore, not covered Loss under the policy. Although the payment was characterized as a donation, the court noted it was neither voluntary nor tax deductible. Rather the Donation was designed to punish and deter wrongdoing and for these reasons was a penalty, accepted and ratified by the court and not covered as Loss under the policy. *Phila. Indemn. Ins. Co. v. Sabal Ins. Grp. Inc.,* 2019 U.S. App. LEXIS 25542 (11th Cir. 2019).

Part IV: Securities and Corporate Governance

Demand Futility

Derivative Suit was Properly Dismissed because Shareholders did not make a Pre-Suit Demand on the Board or Show Demand Futility

In this derivative action, the shareholders of a corporation that facilitates electronic money transfers through an international network alleged that the directors and officers breached their fiduciary duties to the company by failing to implement and maintain an effective anti-money laundering compliance program ("AML compliance program"). The shareholders did not make a pre-suit demand on the board of directors to pursue this litigation.

The lower court determined that the shareholders presented no evidence that the demand would have been futile and, therefore, the shareholders' obligation to make a pre-suit demand on the board was not excused. Because the shareholders did not make a pre-suit demand, the issue before the appellate court was whether such demand would have been futile. Under Delaware law, the shareholders are required to plead the reasons that a pre-suit demand would be futile. Delaware law employs two tests, which depend on the nature of the allegations against the board. If the shareholders allege that the board acted in violation of their fiduciary duties, "demand is excused if a 'reasonable doubt' exists that (i) the directors are disinterested and independent or (ii) the transaction is 'otherwise the product of a valid exercise of business judgment.'" Conversely, allegations of board inaction "require a 'reasonable doubt' that, when the lawsuit was filed, the board 'could have properly exercised its independent and disinterested business judgment in responding to a demand.'"

The shareholders in the derivative action did not challenge any affirmative action by the board but, rather, alleged that the board "failed to implement and maintain an effective AML-compliance program despite knowing of systemic deficiencies in [the corporation's] AML compliance." To prevail, the shareholders in this matter must plead facts "demonstrating that at least half of [the directors] could not have exercised disinterested business judgment in responding to a demand. [ ] A director is considered interested if filing suit would operate to his or her 'personal benefit or detriment.'" The Court of Appeals for the Tenth Circuit concluded that the shareholders did not allege that the board was aware of violations of the AML compliance program when they occurred or that any director "consciously and in bad faith had failed to take corrective action." The shareholders failed "to establish that a majority of [the corporation's] Board...faced a substantial risk

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of personal liability for consciously disregarding that misconduct." Accordingly, the court held that "because the Board could have impartially acted on a pre-suit demand to pursue litigation...the Shareholders' obligation to make such a demand wasn't excused." *City of Cambridge Ret. Sys. v. Ersek*, 2019 U.S. App. LEXIS 11077 (10th Cir. 2019).

Duty of Loyalty

Delaware Supreme Court Finds Potential Liability for Outside Directors

In a rare finding of potential liability for outside directors, the Supreme Court of the State of Delaware overruled the Chancery Court's dismissal of an action against various board members of a large food manufacturer. Chief Justice Strine described the underlying facts as outlined in the complaint and disagreed regarding potential liability for a breach of the duty of loyalty under *In Re: Caremark Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

One of the largest ice cream manufacturers in the United States suffered a listeria contamination in each of its three manufacturing facilities. After three people died, there was a significant layoff of its workforce and the company was forced to accept a private equity investment in order to continue operations and avoid a liquidity crisis. The lower court focused on the highly-regulated industry in which the company operated. With FDA compliance, state regulatory manufacturing requirements, and internal food safety standards, the lower court ruled that plaintiffs had not plead facts supporting the contention that the board failed to adopt or implement an appropriate food safety compliance system. The lack of effectiveness of compliance, in the lower court's opinion, was not a sufficient basis for board liability.

In overruling the dismissal, the Supreme Court of the State of Delaware described that the complaint alleged a complete failure by the board to attempt to assure that reasonable information was flowing to, and reported to, the board for appropriate action. Further, the board demonstrated a lack of interest in food safety, arguably a critical component for the continued success of the company. This, according to the court, supported a claim for breach of the duty of loyalty under Delaware law. The complaint alleged that the board ignored red and yellow flags from both regulators and its own internal testing. Condensation was first discovered in one manufacturing facility in 2009 and there were positive tests for listeria in 2013. The board allegedly did not even discuss such concerns at any meeting, did not form a food safety committee, or otherwise show an interest in addressing a problem that led to the deaths of three customers. Such disinterest, according to Justice Strine, could support liability for breach of the duty of loyalty. The court also ruled that the plaintiff had properly pleaded demand futility by alleging that a majority of the company's directors lacked independence. *Marchand v. Barnhill*, 2019 Del. LEXIS 310 (Del. 2019).

Forum Selection

Delaware Forum Selection Clause does not Conflict with California Law

The California Court of Appeals held that a Delaware forum selection clause contained in the bylaws of a California-based company did not conflict with California law. Further, California law did not provide plaintiff a separate right to litigate his claims in California.

A Los Angeles based financial company, incorporated in Delaware, announced plans to merge with another financial organization. At the time of the transaction, the defendant's certificate of incorporation authorized the board of directors to "adopt, alter, amend or repeal the company's bylaws." The defendant amended the bylaws at the time of the merger agreement and added a forum selection bylaw stating that Delaware is "the sole and exclusive forum for intra-corporation disputes, including any action asserting breach of fiduciary duty." The plaintiff, a California resident and shareholder, filed a lawsuit in California state court alleging breach of fiduciary duties relating to the merger transaction. The trial court found the bylaw was enforceable and on appeal the plaintiff contended the trial court erred in enforcing the forum selection bylaw.

In considering the matter, the appellate court recognized that unilaterally adopted forum selection bylaws were increasingly popular and that other states have litigated the issue. Of note, the parties did not dispute the application of Delaware law "under the internal affairs doctrine which generally requires application of the law of the state of incorporation to any dispute regarding relations between the corporation and its shareholders or officers and directors," nor did the parties dispute the validity of the bylaw under Delaware law. Rather, the dispute was whether California law renders the otherwise valid bylaw unenforceable in California and whether a forum selection bylaw adopted by a Delaware corporation without shareholder consent is enforceable in California. The plaintiff cited the California Corporations Code as providing a right for his action to be brought in California. That provision states:

> [t]he directors of a foreign corporation transacting intrastate business are liable to the corporation, its shareholders, creditors, receiver, liquidator or trustee in bankruptcy for the making of unauthorized dividends, purchase of shares or distribution of assets or false certificates, reports or public notices or other violation of official duty according to any applicable laws of the state or place of incorporation or organization, whether committed or done in this state or elsewhere. Such liability may be enforced in the courts of this state.

In rejecting the plaintiff's argument, the court observed that "nothing in the provision requires a California court to exercise jurisdiction over such a case where it finds that in the interest of substantial justice the action should be heard in another forum." As such, the forum selection clause does not violate public policy. With respect to the plaintiff's argument that the bylaw should not be enforced because it was adopted in connection with the challenged merger transaction, the court reasoned that "[f]orum selection bylaws have the effect of consolidating such litigation into a single forum, thereby reducing litigation expenses and avoiding duplication of effort (not to mention promoting efficient use of judicial resources), which is beneficial to corporations and their shareholders alike." The court noted the "forum selection bylaw is entirely consistent with [plaintiff's] reasonable expectations at the time he chose to purchase

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stock in [the Company]. At that time, [plaintiff] knew or should have known that [the Company] was a Delaware corporation and that, consistent with Delaware law, its certificate of incorporation empowered its directors to amend the corporate bylaws unilaterally, subject to subsequent shareholder repeal." Lastly, a forum selection clause need not be subject to negotiation to be enforceable. *Drulias v. 1st Century Bancshares, Inc.*, 2018 Cal. App. LEXIS 1202 (Cal. App. 2018).

Securities Cases

Post-*Cyan* Securities Lawsuit Dismissed

A retailer completed its initial public offering ("IPO") on April 12, 2017. Thereafter, the retailer – along with certain of its directors and officers and offering underwriters - faced a securities class action lawsuit. The complaint alleged that the retailer's registration statement and prospectus painted a materially false and misleading picture of the retailer's business, thereby inflating the offering price. The plaintiff shareholders alleged that the offering documents misleadingly touted the company's "competitive" position, its "high margin" business strategy, and its new vitamin and supplements distribution business. Rather than the picture painted in the offering documents, the complaint conversely alleges that the company actually faced intense competitive pressure that forced the company to offer steep discounts and increase its marketing, undermining its supposed high margin business model. The plaintiffs also specifically alleged that at the time of the IPO the defendants knew or should have known that the company's 2016 financial statements were overstated because certain substantial write-downs taken subsequently for its accounts receivable meant that there must have been a return policy that was not disclosed to investors. The complaint alleged that the defendants' misrepresentations and omissions violated Sections 11 and 12(a)(2) of the Securities Act of 1933.

In granting the defendants' motion to dismiss the complaint, the court ruled that none of the statements about past performance were actionable, as they amounted to expressions of puffery and corporate optimism. The court also ruled that the retailer's statements regarding the level of competition and its competitive position in Brazil were unactionable opinion. In reaching this conclusion, the court relied upon the U.S. Supreme Court's 2015 opinion in *Omnicare,* in which the Supreme Court held that to be actionable, opinion statements must be both false and not honestly believed when made. The court also noted that the statements of opinion about competition were counterbalanced by extensive disclosure in the risk factor section of the prospectus.

The court also rejected plaintiffs' allegation that the company hid the poor performance of its vitamins and supplements business. The court noted that it was undisputed that the retailer had not restated its financial documents; but rather increased its allowance for "doubtful accounts." The court sternly stated that the accounting rules that were purportedly violated require a company's judgment to determine which accounts receivable are collectable based on the facts and circumstances of those sales. The court found that the complaint failed to plead facts that the retailer did not subjectively believe its accounting judgments at the time these judgments were made. Finally, the court found that the retailer's statements of future growth were not actionable under the safe harbor for forward looking statements and were protected by the "bespeaks caution doctrine" as they "[were] accompanied by cautionary language such that, when examined in the context of the total mix of information, [they] would not mislead an investor." *In re Netshoes Sec. Litig.,* 2019 N.Y. Misc. LEXIS 3909 (Sup. Ct., NY Cty. 2019).

New York State Court Holds PSLRA Stays Discovery in State Securities Act Cases

In a decision diverging from two previous New York state cases, the New York County Commercial Division stayed discovery pending a motion to dismiss a federal securities class action pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA").

Shareholders of a company brought a class action in New York state court, alleging claims under Sections 11, 12 and 15 of the Securities Act of 1933. The plaintiffs alleged that the company inflated certain financials and made misrepresentations in the registration statement and prospectus issued in connection with its initial public offering. The company moved to dismiss the action, and to stay discovery pursuant to the PSLRA's automatic stay rule. The plaintiffs opposed the motions, and argued that the PSLRA's automatic stay of discovery was inapplicable to state court actions.

The court conducted an in-depth analysis of the text of the PSLRA and the Securities Litigation Uniform Standards Act ("SLUSA"), and held that "the simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss '[i]n any private action arising under this subchapter,'" and "[n] owhere in [the PSLRA] does the statute indicate that it applies only to actions brought in federal court." The court rejected plaintiffs' arguments that the PSLRA's invocation of the Federal Rules of Civil Procedure in connection with discovery obligations implied that the PSLRA only governed in actions brought in federal court. The court also rejected plaintiffs' contention that if the discovery stay applied, state court procedures—such as preliminary conferences and mediation—could not occur during the stay. The court pointed out that "state court proceedings are often stayed for a host of other reasons" and Rule 11(d) of the New York Supreme Court's Commercial Division "expressly permits the stay of discovery pending the determination of a dispositive motion."

[Ed,] The decision is particularly intriguing as it runs contradictory to two New York County Commercial Division decisions decided earlier in 2019, holding that the PSLRA discovery stay did not apply in state court actions. See, *Matter of PPDAI Group Sec. Litig.,* 2019 N.Y. Misc. LEXIS 3481 (NY Cty., 2019); Matter of *Dentsply Sirona, Inc. Shareholders Litig.,* 2019 N.Y. Misc. LEXIS 4260 (NY Cty., 2019). Whether the New York Appellate Division will have an opportunity to address the applicability of the PSLRA's automatic stay of discovery to state court Securities Act cases remains to be seen. *Matter of Everquote Inc. Sec. Litig.,* 2019 N.Y. Misc. LEXIS 4285 (Sup. Ct., NY Cty. 2019).

Connecticut State Court Grants Motion to Strike Securities Act Claims

The Superior Court of Connecticut (Judicial District of Stamford) granted the defendants' motion to strike the plaintiff's complaint in a putative class action alleging violations of the Securities Act of 1933 ("Securities Act") in connection with disclosures made for an initial public offering ("IPO") of debt securities. The court concluded that the revenue declines, which the defendants did not disclose, were no more than ordinary business fluctuations.

The plaintiff alleged that the defendants violated the Securities Act by failing to disclose third quarter declines in one of its business segments and the corresponding effects on the company's financial performance. The plaintiff alleged that various financial documents incorporated by reference in the IPO prospectus contained misleading statements concerning the company's third quarter 2017 performance. The plaintiff alleged that the defendants failed to disclose the company's decreasing revenues and sales for some of its services, which affected its net income. The plaintiff also alleged that the declines were "trends" or "uncertainties" that triggered an obligation to make additional disclosures pursuant to Item 303 of the Securities and Exchange Commission Regulation S-K (17 CFR § 229.303). Further, the defendants were allegedly aware of these issues at the time of the IPO. The defendants countered that Item 303 did not require disclosures of third quarter performance because the declines in performance during that quarter were not "trends" or "uncertainties" as defined in Item 303 and that it was not unreasonable for the defendants to conclude that these would not have a materially adverse impact. The defendants also contended that their statements about recurring revenues and sales were truthful and that none of the alleged omissions were material.

The court determined that "[n]othing in the plaintiff's complaint suggests that this decline was part of an ongoing pattern, nor that it was caused by a persistent condition affecting [the company's] business rather than ordinary, quarter-to-quarter business fluctuations." Accordingly, it found the defendants under no independent duty to disclose the alleged declines during a quarter that had not yet closed and emphasized that "accurate statements of historical fact cannot form the basis of a securities claim." In finding for the defendants, the court held that the company was "under no obligation to disclose these alleged declines prior to, or contemporaneously with, the IPO." *City of Livonia Retiree Health & Disability Benefits Plan v. Pitney Bowes, Inc.*, 2019 Conn. Super. LEXIS 1604 (Conn. Super. Ct. 2019).

Securities Class Action Dismissed Against Social Media Company

The United States District Court for the Northern District of California dismissed without prejudice the privacy related securities class action which followed a data mining scandal and General Data Protection Regulation (GDPR) readiness/compliance issues involving a social media giant. The court concluded that the plaintiffs had not shown the requisite misleading intent or recklessness to support a valid securities claim.

The complaint was a consolidation of two separate class actions filed against the social media company and individual defendants. The initial suit followed the adverse publicity that grows upon the company's disclosure that user data had been accessed by a third-party firm to target users with political advertisements. The securities suit alleged that the company had misled investors about the protection of user information and privacy policies. The second suit focused upon the representations concerning the impact on the company (including user slowdown) by the newly imposed privacy regulation, GDPR. The consolidated complaint alleged a total of thirty-six individual misleading statements by the company downplaying the impact of the data use and GDPR situations. In reviewing the statements, the court determined that the complaint failed to specifically identify instances where the company or its executives knowingly made such statements and noted that some were forward-looking predictions or expressions of corporate optimism. The court addressed a particular individual statement which could be shown to be false, in which the company's chief operating officer ("COO") stated in a 2017 interview, "When you share on [the social media site], you need to know that no one's going to steal our data. No one is going to get your data that shouldn't have it.... you are controlling who you share with." The court did fully dismiss the case, notwithstanding this one actionable statement, on the basis that the plaintiffs had not shown that the COO acted with misleading intent or recklessness needed to support a valid securities claim.

Given that the court issued its dismissal without prejudice, the case is expected to be closely watched for the plaintiffs to replead their allegations with more particularity. *In re Facebook, Inc. Sec. Litig.*, 2019 U.S. Dist. LEXIS 166027 (N.D. Cal. 2019).

Part V: Other Cases of Interest

Americans with Disabilities Act

Ninth Circuit finds ADA Applies to Website and Mobile App for Business with Physical Location

The Ninth Circuit Court of Appeals reversed a lower court's dismissal of a pizza delivery and restaurant chain's ("restaurant") website and mobile application ("app") accessibility lawsuit but did not decide whether the website and app violate the Americans with Disabilities Act ("ADA").

The plaintiff, a blind man, accesses the internet using screen-reading software, which vocalizes visual information on websites. The restaurant operates a website and app that allows customers to order pizzas and other products for at-home delivery or in-store pickup, and to receive exclusive discounts. The plaintiff alleges that on at least two occasions, he unsuccessfully attempted to order online a customized pizza from one of the restaurant's locations. He contends that he could not order the pizza because the restaurant failed to design its website and app so his software could read them.

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The plaintiff filed suit seeking damages and injunctive relief based on the restaurant's failure to "design, construct, maintain, and operate its [website and app] to be fully accessible to and independently usable by [plaintiff] and other blind or visually-impaired people," in violation of Title III of the ADA and California's Unruh Civil Rights Act ("UCRA"). The ADA requires that covered entities provide auxiliary aids and services to ensure that individuals with disabilities are not excluded from accessing the services of a "place of public accommodation." The plaintiff seeks to require the restaurant to comply with Web Content Accessibility Guidelines ("WCAG") 2.0 (private industry accessibility standards) for its website and mobile app.

The Ninth Circuit held that the ADA applied to the website and app because the Act mandates that places of public accommodation, like the restaurant, provide auxiliary aids and services to make visual materials available to individuals who are blind. The panel stated that even though customers primarily accessed the website and app away from its physical restaurants, "the ADA applies to the services of a public accommodation, not services in a place of public accommodation." The panel stated that "the website and app connected customers to the physical restaurants' goods and services." The panel also held that the ADA was not impermissibly vague, and that the restaurant had received fair notice that its website and app must comply with the ADA. The Ninth Circuit also held that the restaurant's statutory duty was not eliminated by the lack of specific regulations not yet promulgated by the Department of Justice. The panel rejected the restaurant's argument that imposing liability under the ADA would violate its due process rights.

The Ninth Circuit, however, did not decide if the ADA applies to websites or apps "where the inaccessibility does not impede access to good and services of a physical location." The court, likewise, stopped short of deciding whether that the restaurant's website and app violated the ADA, and remanded the case to the lower court to decide that question. *Robles v. Domino's Pizza, LLC*, 2019 U.S. App. LEXIS 1292 (9th Cir. 2019).

Illinois Supreme Court Holds that Individuals Need not Plead Actual Damages in Order to have Standing under the Biometric Information Privacy Act

The Illinois Supreme Court has decided an important threshold issue related to the Biometric Information Privacy Act ("BIPA"). BIPA was enacted in 2008 to help regulate "the collection, use, safeguarding, handling, storage, retention, and destruction of biometric identifiers and information." BIPA's definition of biometric identifier includes fingerprints, among other things. BIPA provides that "any person aggrieved by a violation of this Act shall have a right of action... against an offending party."

The court held that "an individual need not allege some actual injury or adverse effect, beyond violation of his or her rights under the Act, in order to qualify as an 'aggrieved' person and be entitled to seek liquidated damages and injunctive relief."

The instant class action lawsuit involved an amusement park's practice of utilizing scanned fingerprints to allow cardholders access to the park. The named plaintiff (on behalf of her minor son) alleged that her son's rights had been violated when the park scanned his fingerprint without having provided the requisite notice and consent under BIPA.

The defendant amusement park moved to dismiss the plaintiffs' claims on the basis that plaintiffs had no standing where there were no allegations of actual or threatened injury. After several lower court and appellate rulings, the Illinois Supreme Court looked to the statutory intent and construction. In its analysis, the court identified instances where the legislature had utilized different wording when it required an 'actual damage' threshold, differentiating those statutes from BIPA. The court also looked to the plain language of the statute and the limited meaning of the word "aggrieved," as determined in prior jurisprudence and currently defined in legal dictionaries. It also considered the General Assembly's comments regarding the statute, where it was noted that once biometric identifiers are compromised, "the individual has no recourse, is at heightened risk for identity theft, and is likely to withdraw from biometric-facilitated transactions." Because the full ramifications of biometric technology are unknown, the General Assembly, via BIPA, imposed safeguards to protect privacy rights, by subjecting violators to substantial potential liability. The court also noted that compliance expense was insignificant compared to the "substantial and irreversible harm that could result if biometric identifiers and information are not properly safeguarded." After taking these points into consideration, the Illinois Supreme Court reversed the appellate court and remanded to the circuit court for further proceedings. *Rosenbach v. Six Flags Entm't Corp.*, 2019 Ill. LEXIS 7 (Ill. 2019).

Illinois Court Uses *Rosenbach* Decision to Confirm Liquidated Damages Available under BIPA without Showing Actual Injury

In March 2019, the Appellate Court of Illinois heard a case alleging violations of Illinois' Biometric Information Privacy Act ("BIPA") against a tanning company. The putative plaintiff alleged that she was required to provide her fingerprint every time she used the tanning company's services, but that she never signed a release permitting collection and storage of her fingerprints and never was informed of the company's retention policy, in violation of BIPA. The company moved to dismiss the complaint for failure to state a claim and for lack of standing. The circuit court found that the plaintiff had standing, but she had not sufficiently alleged recoverable damages.

In the meantime, a separate BIPA case (*Rosenbach v. Six Flags Entertainment Corp.*) was pending before the Illinois Appellate Court. That court determined that Rosenbach did not have standing. After that decision became public, the circuit court dismissed the case against the tanning company. Rosenbach appealed and, as previously reported, the Illinois Supreme Court overturned the appellate court decision in *Rosenbach*, holding that a plaintiff does not need to plead actual harm or injury resulting from an alleged violation of the Biometric Information Privacy Act ("BIPA") to have standing. After that decision was issued, the putative plaintiff in the tanning company case filed a motion for summary reversal of the circuit court decision.

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In its opposition, the tanning company argued that the Illinois Supreme Court was not clear when it said that BIPA "subject(s) private entities who fail to follow the statute's requirements to *** liquidated damages *** whether or not actual damages, beyond violation of the law's provisions, can be shown." Essentially, it was arguing that the court left unresolved whether a plaintiff would be entitled to liquidated damages without evidence of injury beyond a technical statutory violation. The Illinois Appellate Court disagreed, finding that the plaintiff not only had standing, but had also stated a claim for liquidated damages even if she had not alleged actual damages beyond violation of law. *Rottner v. Palm Beach Tan, Inc.*, 2019 Ill. App. Unpub. LEXIS 328 (Ill. App. 2019).

Five-Year Statute of Limitations Applies to Claims under the Biometric Information Privacy Act

An Illinois circuit court recent denied a defendant hospitality company's motion to dismiss Biometric Information Privacy Act claims. Defendants argued that dismissal was appropriate because the claim was preempted by the Illinois Workers' Compensation Act ("IWCA") and because the claims were barred by the statute of limitations. On the preemption issue, the court relied on a previous circuit court opinion that held that "plaintiff's loss of her ability to maintain her privacy rights under BIPA was neither a psychological nor a physical injury and thus was not compensable under the IWCA."

On the statute of limitations issue, the court considered three different limitation periods: (1) the one-year statute of limitations for "slander, libel, or publication of matter violating the right of privacy"; (2) the two-year limitation applicable to actions for statutory penalties; and (3) the five-year "catch all" limitation period. The court rejected the one-year statute of limitations because there was no publication. The court rejected the two-year statute of limitations as well, after finding that the statute was remedial, not penal, in nature. Before reaching a conclusion, the court considered previously established factors. A statutory penalty is considered 'penal' if it: "(1) imposes automatic liability for a violation of its terms; (2) sets forth a predetermined amount of damages; and (3) imposes damages without regard to the actual damages suffered by the plaintiff." BIPA allows recovery of the greater of actual or liquidated damages; therefore, the third prong was not met, so the court held that the two-year statute of limitations did not apply.

After finding that neither the one-year, nor the two-year, statute of limitations applied, the court concluded that that the five-year "catchall" statute of limitations would apply. However, the court was unable to determine whether the five-year statute of limitations barred the claims due to conflicting affidavits on the issue. Accordingly, it denied defendants' motion to dismiss. *Robertson v. Hostmark Hospitality Grp.*, 2019 Ill. Cir. LEXIS 119 (Cir. Ct., Cook Cty. 2019).

Crypto-Currency

Court Rules Crypto-Currency is Property Rather than Money

In what may be a case of first impression, an Ohio state court determined that Bitcoin constituted covered "property," rather than "money," under the terms of a homeowners' insurance policy, such that coverage for its loss was not restricted to a policy sublimit for "money" loss.

In denying the insurers' motion for judgment on the pleadings, the court discredited the insurers' citations to an array of media reports, from sources including CNN, CNET, and the New York Times, to demonstrate that Bitcoin was widely recognized as "money." The only legal reference the insurer used to support its conclusion was a limited reference to an IRS document relating to the taxation of Bitcoin – in which the IRS cited the term "virtual currency" to describe Bitcoin. Conversely, the insured cited a number of federal cases and a Florida case in support of his position that Bitcoin was property. The Ohio court discredited the cases cited by the insured, finding them neither governing nor persuasive.

In reaching the conclusion that Bitcoin was "property" under the policy and not "money," the court relied upon the IRS Notice cited by insured. IRS Notice 2014-21 states, "[f]or federal tax purposes, virtual currency is treated as property." The court found this persuasive and held that "virtual currency is recognized as property by the IRS and shall be recognized as such by this [c]ourt." Accordingly, the insured's loss was not subject to the two-hundred dollar "money" sublimit in the policy. It will be interesting to see if other courts adopt a similar viewpoint of Bitcoin. *Kimmelman v. Wayne Ins. Grp.*, 2018 Ohio Misc. LEXIS 1953 (Ct. Com. Pl. 2018).

Standing

Court Rejects Settlement in Cyber Case where Parties Lacked Standing

On a motion to approve a class-action settlement, which was unopposed, the court declined to approve the settlement on the basis there was no evidence of injury, thus the plaintiffs lacked Article III standing.

In this matter, an employee of a mental and behavioral services company, which provided services to veterans and others, sent an email which contained personal information of approximately 130 current and former clients. The email was only distributed internally to current employees of the company. Several people whose information had been shared sued on behalf of a class of all those whose information had been shared, alleging negligence and violations of several states' laws. While the defendants moved to dismiss the complaint for lack of Article III standing, amongst other things, the parties subsequently agreed to settle the matter. However, the court declined to approve the $60,000 settlement or award attorneys' fees on the grounds the plaintiffs lacked standing. In reaching this conclusion, the court addressed the role and limits on federal courts, noting that "[o]ne critical limit set forth in Article III of the United States Constitution is that all suits filed in federal court must be 'cases and controversies of the sort traditionally amenable to, and resolved by, the judicial process'." The court further added that "a court is powerless to approve a proposed class settlement if it lacks jurisdiction over the dispute, and federal courts lack jurisdiction if no named plaintiff has standing." In discussing the standing requirements, plaintiff must allege an "injury in fact" which is "an invasion of a legally protected interest that is concrete and particularized and actual or imminent, not conjectural or hypothetical" and also noted

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that “although imminence is concededly a somewhat elastic concept, it cannot be stretched beyond its purpose, which is to ensure that the alleged injury is not too speculative for Article III purposes.” While the court did note other cases where plaintiffs established standing against an entity that held their personal identifying information in a “data breach” by showing an increased risk of future identity theft, the court distinguished those cases by noting at least one named plaintiff in those cases had alleged misuse of his or her information by the data thief. Furthermore, in these “data breach” cases, the data was “stolen by hackers or cyber criminals who had intentionally targeted the data.” The court distinguished between personal information targeted by a hacker where the purpose of the hack is to fraudulently use the stolen information at some point, thereby creating a substantial risk of harm which satisfies the injury requirement, versus situations where courts have determined “in the absence of an allegation or evidence that an unauthorized third party intentionally stole the data at issue, courts have concluded that the risk of identity theft is too speculative to support Article III standing.”

Applying these principles, the court found there were no allegations the data was misused or that a class member’s identity was stolen because of the breach. The court also took notice that the errant email was shared with employees of the company who deal with sensitive information of all kinds and were at risk of being fired if they did anything untoward with the email. The court concluded plaintiffs “cannot manufacture standing merely by inflicting harm on themselves based on their fears of hypothetical future harm that is not certainly impending.” *Steven v. Carlos Lopez & Assocs.,* 2019 U.S. Dist. LEXIS 203621 (S.D.N.Y. 2019).

Cyber Corner

First Quarter

Cyber Attack on Norwegian Aluminum Manufacturer Emphasizes Need for Cyber Insurance

On March 19, Norwegian-based aluminum manufacturer Norsk Hydro was the victim of what it described as an "extensive cyberattack" that impacted the company's IT systems in both Europe and the United States. The attack forced a shutdown of the company's global computer network, resulting in a necessary switch to manual operations at its plants or the temporary shutdown of production entirely.

Following the attack, Norsk Hydro reported that output of its extrusion business, which makes components for carmakers, builders and other industries, was reduced by 50 percent.

Recovery from the incident involved the gradual restoration of its global IT system. The resumption of production was equally incremental, and, on April 5, the manufacturer reported that production in its Extrusion Europe, Extrusion North America and Precision Tubing business units were running at an average output of around 90 percent. However, the company's Building Systems unit was still only operating at approximately 75 percent and had not significantly improved from the standstill immediately following the attack.

Norsk Hydro preliminarily estimated a financial impact of the attack NOK300 million and NOK350 million, approximately $35-$40 million in US dollars, for the first full week after the cyberattack. Given that production had not been fully restored well into April, those estimates are likely to increase by the time pre-attack production levels are reached. In addition to the estimated financial impact, the attack also caused the company to delay its quarterly financial reports for Q1 2019, stating only that the revised date for the reporting was conditioned upon the timeline for restored operational and reporting systems.

Lessons Learned: Although the attack to Norsk Hydro has only yielded a preliminary estimate as to financial impact, those early numbers alone underscore the significance of a cyber attack both to Norsk, and to manufacturers generally. As was the case with the NotPetya attacks, the potential business income loss after several weeks of impaired production will undoubtedly increase from the early approximation and have the potential to impact the manufacturer's Q1 finances once reported. Although Norsk was quick to disclose that it had purchased cyber insurance which it believes will respond to the incident, many manufacturing clients and prospects still do not effectively insure for large-scale business income losses from cyber attacks, thus emphasizing the need to educate manufacturers on both the large-scale exposures from cyber, and the risk transfer solutions available to protect their balance sheet.

Second Quarter

Increasing Regulatory Fines and Penalties for Privacy Protection Violations Elevate Corporate and Executive Risk

Within a matter of days, both British Airways and Marriott were reported to be facing proposed fines for breaches reported in 2018. The reported amounts — approximately $230 million USD in the case of British Airways and approximately $112 million USD for Marriott — would represent the largest fines levied to date since the May 2018 effective date of the European Union's General Data Protection Regulation ("GDPR"). These fines not only reinforce the gravity and significant regulatory exposure for inadequate data protection, but also call attention to increased operational and financial exposures for which management may face scrutiny.

The fine proposed by the UK Information Commissioner's Office (ICO) against British Airways arises under the UK Data Protection Act and relates to an incident that the airline reported to ICO in September 2018. The personal data of approximately 500,000 customers was compromised in the incident, which diverted user traffic on the British Airways website being diverted to a fraudulent site, where the personal information was harvested.

Unlike the British Airways fine, the fine against Marriott is being levied by ICO under the GDPR in connection with a security breach reported in 2018, whereby information related to approximately 339 million customers was compromised. Although reported in 2018, the Marriott breach is believed to have initially occurred at Starwood prior to Marriott's acquisition of Starwood. In fact, in proposing the fine against Marriott, the ICO specifically referenced Marriott's lack of due diligence around Starwood's cyber security during the acquisition.

Lessons Learned: The steep fines proposed against Marriott and British Airways represent the most glaring example of the sharp enforcement teeth of GDPR and similar regulatory frameworks. However, as massive as these fines were, neither reported fine amount comes close to representing 4% of either company's worldwide revenue, which is the maximum fine allowable under GDPR. Consequently, the staggering regulatory exposure facing organizations can quickly and significantly impact operations and the balance sheet. In addition, as the Marriott breach reflects, regulators — and no doubt plaintiffs' counsel — are scrutinizing the level of cyber security diligence being exercised in connection with acquisitions. Given the heightened focus on mergers and acquisitions diligence and the need for effective risk transfer solutions for regulatory exposures, it is important to consider proactive and reactive products and services that can help companies, which include developing GDPR compliance protocols, providing services in connection with cyber due diligence in mergers and acquisitions, and delivering best in class risk transfer solutions for regulatory exposures.

Third Quarter

The Federal Trade Commission for 2017 Data Breach

The Federal Trade Commission announced in July 2019 that it had reached a settlement with Equifax Inc. in connection with Equifax's 2017 data breach which, according to the FTC, compromised close to 150 million names and dates of birth, another 145.5 million Social Security numbers, as well as approximately 200,000 payment card numbers and expiration dates. The FTC settlement was part of a global settlement agreement with other Federal agencies,

Continues

states and territories and ultimately may require Equifax to pay up to $700 million.

The settlement requires Equifax to pay $300 million to a fund that will be used to fund credit monitoring services and compensate individuals impacted by the breach, with up to $125 million in additional proceeds to be paid into to the fund if needed due to the number of claims. The initial announcement of the settlement indicated that claimants could receive up to $20,000 in compensatory damages for time and expense spent remedying consequences of the breach such as identity theft or misuse of personal information.

Additionally, claimants without provable damages were entitled to up to ten years of credit monitoring or a cash payment of up to $125 without proof of damages. However, subsequent communications from the FTC in September 2019 indicated that the amounts paid might be “substantially less” than $125 depending on the number of claims that were filed. Claimants electing the cash payment of up to $125 were also required to submit proof that they had credit monitoring services for at least 6 years before October 15, 2019. These subsequent disclosures were met with vocal criticism from consumer watchdogs and politicians who characterized the initial settlement announcement as watered down or misleading.

Similar to other data breach settlements, the FTC also required Equifax to implement and maintain requisite security programs with board oversight and annual certification. Included in the requirements is third-party assessment of network security and the programs implemented as a result of the settlement.

Lessons Learned: The Equifax settlement with the FTC is the latest example of the ever-escalating costs of data breach for entities whose network security is compromised. Although the types of compensatory and regulatory fines at the heart of the settlement are typically covered under many, if not most, cyber insurance policies, the sheer magnitude of the settlement amounts is a reminder to discuss both the breadth of coverage for regulatory and third-party claims, but also to continually evaluate exposure and adequacy of limits through a Cyber Impact Analysis and other quantitative tools.

Fourth Quarter

Is A Federal Privacy Law Coming in 2020?

While the end of 2019 on Capitol Hill had the nation’s attention focused on the impeachment hearings, three separate Congressional efforts to enact a Federal privacy law emerged to comparatively little fanfare by the media and the public. On November 26, 2019, Senator Maria Cantwell (D-WA) introduced the Consumer Online Privacy Rights Act (“COPRA”), while Senator Roger Wicker (R-MS) introduced the United States Consumer Data Privacy Act of 2019. Finally, on December 18, in the House Energy and Commerce Committee released a bipartisan staff-level draft privacy bill.

The COPRA bill introduced by Senator Cantwell proposes several privacy protections already seen in various state privacy laws and regulations, including an individual’s rights to view their data and be “forgotten” through deletion of the data. In additional, the bill proposes increased fines for privacy offenses, and proposes stringent permission requirements on companies seeking to collect sensitive data and biometric information. Additionally, COPRA proposes expansion of the Federal Trade Commission’s power through the creation of a specific bureau of privacy within the FTC. Consumers would also have a private right of action under the proposed law.

Senator Wicker’s bill proposes many measures and protections similar to COPRA and proposes heightened corporate accountability through designated privacy officers whose focus would be compliance with the new law. However, the Wicker bill differs in two key areas that raise questions as to whether a compromise could be reached in the Senate.

First, the Wicker proposal does not include a private right of action for consumers. Although currently absent from the Wicker bill, the Senator has indicated he would consider amending to include a narrow private right. The second major difference from COPRA is that the Wicker proposal expressly seeks to pre-empt state privacy laws in favor of a new Federal standard. While a singular, national standard for privacy is seen by many as a positive over a fifty-state patchwork approach, critics of the Wicker bill contend that the pre-emption language is designed to protect large technology firms and data aggregators from the mandates of the California Consumer Privacy Act, which went into effect on January 1, 2020.

For its part, the bi-partisan bill released by the House Energy and Commerce Committee is comprehensive in scope, however, much of the language and particulars of the proposed law was not completed before its release and brackets were used where language had not yet been agreed upon by the Committee. Among the language included in the released draft, the bill would provide the FTC with increased authority, including the creation of a Bureau of Privacy, as also proposed in COPRA. Notably, the House draft is silent on the issues of preemption and private rights of action that distinguish the two Senate proposals.

Lessons Learned: While there are varying opinions on whether a Federal privacy law and standard is desirable, there is no question the bills and bill draft released in late 2019 are the furthest Congress has gone towards any such standard. There is a significant amount of overlap and common ground between the three Congressional initiatives, including the competing Senate bills, which suggests that agreement on a privacy bill may not be far. However, the preemption and private right of action issues are significant, potentially polarizing, differences in the Senate drafts that the bi-partisan House draft has not addressed. Whether those issues rise to the level of wedge issues that prevent a Federal law from being approved remains to be seen and will be closely monitored throughout 2020.

SEC Filings

source: www.sec.gov/litigation.shtml

First Quarter

In January 2019, the SEC announced charges against nine defendants for participating in a scheme to hack into the SEC's EDGAR system to utilize its non-public information in illegal trading. The SEC seeks penalties, return of ill-gotten gains with prejudgment interest, and injunctive relief.

In February 2019, the SEC announced that it filed charges against Gordon Coburn and Steven E. Schwartz, the President and Chief Legal Officer of **Cognizant Technology Solutions**. The charges were in connection with Coburn and Schwartz's alleged role in facilitating violations of the Foreign Corrupt Practices Act. The SEC seeks injunctive relief, penalties, and officer and director bars.

In March 2019, the SEC charged **Volkswagen AG**, two of its subsidiaries, and its former CEO, Martin Winterkorn with fraud. The SEC seeks injunctive relief, disgorgement and interest, and civil penalties. It also seeks a director and officer bar against Winterkorn.

Second Quarter

In April, the SEC filed charges against Jeffrey C. Mack (former CEO) and Lawrence C. Blaney (former VP of Sales) of **Digiliti Money Group, Inc.** The SEC is seeking permanent injunctions, disgorgement with prejudgment interest, a civil penalty, and a permanent director and officer bar.

In May, the SEC charged Danny R. Williams, the former president of **Quality Companies, LLC** (a former subsidiary of Celadon Group Inc.), with accounting fraud. The SEC is seeking a permanent injunction, a civil penalty, and a director and officer bar.

In June, the SEC filed charges against **Ability Inc.**, its wholly owned subsidiary, its CEO Anatoly Hurgin, and its Chief Technology Officer Alexander Vladimir Aurovsky. The SEC is seeking permanent injunctions, disgorgement with prejudgment interest, and civil penalties against all defendants. It also seeks a director and officer bar against Hurgin.

In June, the SEC filed charges against four former executives of **Blue Earth Inc.**; CEO Johnny R. Thomas; CFO Jonathan Brett Woodard; President and COO Robert C. Potts; and VP of Corporate Development and Investor Relations John C. Francis. The SEC seeks permanent injunctions, civil penalties, and penny stock and director and officer bars.

Third Quarter

In July 2019, the SEC charged Gary Winemaster, the former CEO of **Power Solutions International,** and two former senior sales executives with accounting fraud. The SEC seeks permanent injunctive relief and penalties, disgorgement and pre-judgment interest against Needham, an officer-and-director bar against Winemaster, and a compensation clawback with respect to Winemaster.

In August 2019, the SEC announced charges against **Live Well Financial, Inc.,** its CEO Michael Hild, its CFO Eric Rohr, and its EVP Darren Stumberger. The SEC seeks a permanent injunction, disgorgement of ill-gotten gains with prejudgment interest, penalties, and a director and officer bar against Hild and Rohr. Stumburger and Rohr have already consented to a partial judgment enjoining them from future violations of certain securities laws.

In September 2019, the SEC charged Tom Simeo, the former Chairman and CEO of **Viking Energy Group, Inc.,** with fraud. The SEC seeks a permanent injunction, penny stock bar, a civil penalty, and a director and officer bar.

Fourth Quarter

In November 2019, the SEC amended a complaint to charge four former executives of **Outcome Health** with fraud. The SEC's amended complaint charges former CEO Rishi Shah, former President Shradha Agarwal, former CFO Brad Purdy, and former Executive VP Ashik Desai with violations of the antifraud provisions of the securities laws. The SEC seeks return of ill-gotten gains plus interest, penalties, injunctive relief, and officer and director bars. The U.S. Attorney's Office for the Northern District of Illinois and the DOJ announced criminal charges against Shah, Agarwal, Purdy and Desai along with two others.

In November 2019, the SEC announced amended fraud charges against **Collectors Café** and its CEO Mykalai Kontilai. The amended complaint alleges that the company and Kontilai violated whistleblower protection rules and made misrepresentations to investors. The SEC seeks injunctive relief, disgorgement plus prejudgment interest, and penalties. Kontilai's wife is also named as a relief defendant.

In December 2019, the SEC announced fraud charges against the former COO, William Eric Meek, and former CFO, Bobby Peavler, of **Celadon Group, Inc.** The SEC seeks permanent injunctions, monetary penalties, and officer and director bars against both individuals.

SEC Settlements and Judgments

source: www.sec.gov/litigation.shtml

First Quarter

In January 2019, U.S. Court of Appeals for the First Circuit dismissed an appeal filed by Howard B. Present, co-founder and former CEO of **F-Squared Investments**. F-Squared had previously agreed to pay $35 million to settle charges, while Present proceeded to trial. He was found liable by the jury on all charges.

In February 2019, the SEC obtained consent judgments against Michael J. Kipp and Joanne K. Viard, the former CFO and Director of External Reporting of **Swisher Hygiene**. The final judgment bars Kipp and Viard from serving as directors or officers of public companies and enjoins them from violating certain provisions of the securities laws.

In February 2019, the SEC obtained final judgment against Francisco Sandoval Herrara and Maria D. Cidre, the former CEO and former CFO, of the Rest of the World operating segment of **General Cable Corp**. The final judgments enjoin Sandoval and Cidre from violating certain provisions of the securities laws. Without admitting or denying the allegations, Sandoval and Cidre agreed to respectively pay civil penalties of $150,000 and $40,000.

In February 2019, the SEC announced that it settled a civil injunctive action against Jack D. Massimino, the former CEO, and Robert C. Owen, the former CFO, of **Corinthia Colleges, Inc.** Massimino and Owen agreed to injunctive relief preventing them from violating certain provisions of the securities laws. Massimino agreed to pay a $80,000 civil penalty and Owen agreed to pay a $20,000 civil penalty.

Second Quarter

In March, the SEC filed and settled fraud charges against Keith Borge, the former controller of the **College of New Rochelle**. There was also a criminal action pending in the Southern District of New York. Borge pled guilty in the criminal action and agreed to a partial settlement of the SEC charges. The settlement is subject to court approval and would permanently enjoin Borge from future misconduct. Potential monetary sanctions will be determined at a later date.

In April, the SEC filed and settled fraud charges against Daniel Mattes, the former CEO of **Jumio, Inc**. Mattes, an Austrian citizen, agreed to an injunction, a U.S. public company director and officer bar, and to pay more than $16 million in disgorgement and prejudgment interest, plus a $640,000 civil penalty. The settlement is subject to court approval.

In April, the SEC filed and settled accounting fraud charges against **Celadon Group Inc.** Celadon admitted to certain violations of the Exchange Act, agreed to a permanent injunction, and agreed to remediate weaknesses in its internal control over financial reporting. The company also agreed to pay $7 million in disgorgement, which is considered satisfied by payment of restitution in a related DOJ action.

In June, the SEC filed and settled fraud charges against **Longfin Corp.**, its CEO Venkata S. Meenavalli, and consultant Andy Altahawi. These charges follow a prior SEC action involving Longfin, Meenavalli, and Altahawi and two affiliated individuals, Dorababu Penumarthi and Suresh Tammineedi; there is also a parallel criminal action pending against Meenavalli. Altahawi, Penumarthi, and Tammineedi agreed to settlements that would resolve the charges. The proposed settlement requires Altahawi to return $21 million of alleged ill-gotten gains, pay a $2.9 million penalty, and surrender his Longfin shares. He also agreed to a 5-year public company director and officer bar, and an industry bar. Penumarthi agreed to pay $1.7 million and Tammineedi agreed to pay $241,000, in addition to injunctive relief.

In June, the SEC filed and settled fraud charges against Andrew J. Duggan and Ghassan "Mark" Hamade, the CEO and COO of **Equal Earth, Inc**. The defendants consented to final judgments permanently enjoining them from violating the antifraud and registration provision of the federal securities laws. The company agreed to pay $6.8 million in disgorgement and prejudgment interest and a $855,000 penalty. Duggan agreed to pay more than $800,000 in disgorgement and interest and a penalty of $167,500 and to a permanent director and officer bar. Hamade agreed to a $167,500 penalty and a permanent director and officer bar. The settlements are subject to court approval.

In June, the SEC charged Robert F.X. Sillerman, the former CEO of **Function(x)**, Inc. with fraud. Sillerman agreed to settle the charges, agreeing to a permanent director and officer bar and a penalty of $179,000. The civil penalty will be paid pursuant to a Chapter 11 plan that is approved in his pending bankruptcy case. The settlement is subject to court approval.

Third Quarter

In September 2019, the SEC charged **Montebello Unified School District,** its former Chief Business Officer Ruben Rojas, and its Superintendent of Schools Anthony Martinez. The SEC settled with Montebello and Martinez. Montebello consented to an SEC order requiring him to cease and desist from future violations of the securities laws and to hire an independent consultant to evaluate policies and procedures. Martinez was ordered to cease and desist from violations of the Securities Act and ordered to pay a $10,000 penalty.

In July 2019, the SEC charged **AR Capital LLC,** its founder Nicholas S. Schorsch, and its former CFO Brian Block with fraud and books and records violations. Defendants consented to entry of a final judgment imposing permanent injunctive relief, requiring disgorgement and prejudgment interest of over $39 million on a joint-and-several basis, and imposing a $14 million penalty against AR Capital, a $7 million penalty against Schorsch, and a $750,000 penalty against Block.

In July 2019, the SEC announced that it settled charges related to accounting fraud against **Conn's Inc.** and its COO, Michael J. Poppe. Conn's consented to entry of a final judgment imposing a $1.1 million civil penalty and enjoining future violations of the Securities Act and Securities Exchange Act.

In August 2019, the SEC announced a final judgment against Hani Zeini, the former CEO of **Sientra, Inc**. Zeini consented to the entry of a judgment permanently enjoining

Continues

violations of the Securities Act and the Securities Exchange Act, requiring payment of a $160,000 civil penalty, and imposing a five-year director-and-officer bar.

In August 2019, the SEC announced charges and a related settlement against **Brixmor Property Group Inc.** and four senior executives (CEO Michael Carroll, CFO Michael Pappagallo, CAO Steven Splain and Senior VP of Accounting Michael Mortimer). Brixmor agreed to pay a $7 million penalty and retain an independent consultant to review controls. Splain and Mortimer agreed to entry of partial judgments imposing injunctive relief with monetary relief and bars to be determined at a later date.

In September 2019, the SEC charged **Mylan N.V.** with violations of the Securities Act and the Securities Exchange Act, for accounting and disclosure failures relating to a DOJ probe into overcharges to Medicaid for EpiPen. The SEC agreed to entry of a final judgment ordering a $30 million penalty and permanently enjoining the company from further violations.

Fourth Quarter

In October 2019, the SEC announced that it settled charges against **FAB Universal Corp.'s** CEO, Christopher J. Spencer, and CFO, John Busshaus. Without admitting or denying the allegations, Busshaus and Spencer agreed to bifurcated settlements. Disgorgement, prejudgment interest, and civil penalties are to be determined at a later date.

In October 2019, the SEC announced that it entered final judgments by consent against **Lek Securities Corp.** and its CEO, Sam Lek. The judgment against Lek Securities imposes a three-year injunction requiring termination of business with foreign customers potentially engaged in manipulative trading and largely prohibiting it from providing intra-day trading for foreign customers. The company also agreed to a censure and to retain an independent compliance monitor for three years. The company, along with Sam Lek, agreed to permanent injunctions from violating certain provisions of the federal securities laws. Lek Securities will also pay a $1 million penalty and $525,892 in disgorgement and Sam Lek will pay a $420,000 penalty. Sam Lek also agreed to associational and penny stock bars with a right to reapply after 10 years.

In October 2019, the SEC announced a final judgment on fraud charges against Bobby Dwayne Montgomery, former Chief Business Officer of **Osiris Therapeutics**. Montgomery consented to a judgment enjoining him from future violations of the securities laws and requiring payment of a $40,000 civil penalty.

In November 2019, the SEC settled fraud allegations involving **MiMedx Group Inc.** Without admitting or denying the allegations, MiMedx agreed to a settlement requiring payment of a $1.5 million penalty. The litigation continues against former executives CEO Parker H. Petit, CFO Michael J. Senken, and COO William C. Taylor.

In December 2019, the SEC announced that it filed and settled certain fraud charges against **Iconix Brand Group, Inc.,** and its former CEO Neil Cole, CFO Warren Clamen, and COO Seth Horowitz. Without admitting or denying the allegations, Iconix agreed to injunctive relief and a $5.5 million penalty. Horowitz consented to injunctive relief, a permanent director and officer bar, and agreed to pay disgorgement and prejudgment interest of $147,000 plus a to be determined amount of penalties. Clamen agreed to cease and desist from future violations and agreed to pay disgorgement and prejudgment interest of nearly $50,000 plus a $150,000 penalty. Clamen is also suspended from appearing and practicing before the Commission as an accountant, with the option to apply for reinstatement after three years. The litigation against Cole continues and the SEC is seeking monetary and injunctive relief including a permanent director and officer bar and reimbursement of incentive-based compensation under SOX.

In December 2019, the SEC entered a final judgment against Harpreet Grewal, the former CFO of **Constant Contact, Inc.** Without admitting or denying the allegations, Grewal consented to entry of final judgment enjoining him from future violations of the securities laws and requiring him to pay disgorgement and prejudgment interest of $250,000 and a $100,000 civil penalty.

FCPA Enforcement Actions

source: www.sec.gov/litigation.shtml

First Quarter

In February 2019, the SEC announced that **Cognizant Technology Solutions Corp**. agreed to pay $25 million to settle allegations for violations of the Foreign Corrupt Practices Act. The Company and two of its former executives allegedly authorized bribes to a senior government official of the Indian state of Tamil Nadu in relation to construction of a new campus the company was building. The SEC's order detailed violations of the securities laws and ordered Cognizant to pay disgorgement/interest of $19 million and a $6 million penalty.

In March 2019, the SEC announced that it resolved charges against **Mobile TeleSystems PJSC** ("MTS") for violations of the Foreign Corrupt Practices Act. The SEC had alleged that the company had funneled money to a corrupt Uzbek official in exchange for business over the course of nearly a decade. MTS consented to entry of an order finding that it violated the securities laws and requiring it to pay $100 million in penalties. The penalty is being credited against a criminal fine and forfeiture MTS is required to pay in a related matter with the U.S. DOJ.

Second Quarter

In May 2019, the SEC announced that it settled charges against **Telefonica Brasil S.A.** for violations of the books and records and internal control provisions of the Foreign Corrupt Practices Act (FCPA). The SEC alleged that the company provided hospitality and tickets to the 2014 World Cup and 2013 Confederations Cup to governmental officials who were involved with or in a position to influence business operations. Without admitting or denying the SEC's findings that the violations occurred, Telefonica agreed to a cease-and-desist order and to pay a $4,125,000 civil penalty.

Third Quarter

In July 2019, the SEC announced that it settled FCPA charges against **Microsoft.** The charges involved allegations that Microsoft's Hungarian, Saudi Arabian, Thai and Turkish subsidiaries provided improper discounts, gifts and travel to third parties that were used, in some cases, to fund improper payments to government officials to secure software license sales. The SEC found that Microsoft violated books and records and internal accounting controls provisions. Microsoft agreed to a cease and desist order and to pay disgorgement and interest of over $16.5 million. The Hungarian subsidiary also agreed to pay a criminal fine of roughly $8.75 million as part of a non-prosecution agreement with the DOJ.

In July 2019, the SEC announced that it settled FCPA charges against **Deutsche Bank AG.** The charges involved allegations that Deutsche Bank employees hire relatives of foreign officials, often over more qualified applicants. The company agreed to pay disgorgement and prejudgment interest totaling over $13 million and a $3 million civil penalty.

In August 2019, the SEC announced that it settled FCPA charges against **Juniper Networks, Inc.** The charges involved allegations that Juniper's Russian subsidiary funded leisure trips for customers and government officials through off-book accounts. The SEC found that Jupiter violated books and records and internal accounting controls provisions. The company agreed to cease and desist from committing or causing violations, and to pay $4 million in disgorgement, roughly $1.25 in prejudgment interest, and a $6.5 million civil penalty.

In September 2019, the SEC announced that it settled FCPA charges against Sridhar Thiruvengadam, the former COO of **Cognizant Technology Solutions Corp.** The charges involved allegations that Thiruvengadam and other executives authorized a bribe payment and schemed to cover it up. Thiruvengadam later helped conceal the payment by making false statements to the company's independent auditor. Thiruvengadam agreed to pay a civil penalty of $50,000. The company previously settled in February 2019.

In September 2019, the SEC announced that it settled FCPA charges against **TechnipFMC plc.** for violations by FMC Technologies prior to its 2017 merger with Technip S.A. The charges involved allegations that FMC used an intermediary to bribe Iraqi government officials in exchange for contracts with Iraqi state-owned oil companies. The SEC found that TechnipFMC violated the anti-bribery, books and records, and internal accounting controls provisions. The company consented to a cease and desist order, agreed to pay disgorgement and prejudgment interest totally over $5 million and to certain non-monetary relief, including an agreement to self-report for three years.

In September 2019, the SEC announced that it settled FCPA charges against **Quad Graphics Inc.** The charges involved allegations that the company's Peruvian subsidiary paid or promised bribes to Peruvian government officials and made other improper payments to win sales contracts and/or avoid penalties and attempted to influence a judicial outcome regarding a tax dispute. The subsidiary also allegedly falsified regards to conceal transactions with a state-controlled Cuban telecom company, subject to US sanctions and export laws. The company agreed to a cease and desist order, and a payment of nearly $8 million in disgorgement and prejudgment interest and a $2 million civil penalty. The company also agreed to self-report on its compliance program for one year.

In September 2019, the SEC announced that it settled FCPA charges against **Barclays PLC.** The charges involved allegations that Barclays provided employment to relatives, friends and associates of government officials in exchange for contracts or other benefits. The SEC found that the company violated the books and records and internal accounting controls provisions. Barclays agreed to pay roughly $6.3 million in disgorgement, interest, and civil penalties.

Fourth Quarter

In November 2019, the SEC announced that it charged Jerry Li, the former managing director of a US based direct selling company in China, with violations of the FCPA. The SEC alleges that Li orchestrated a bribery scheme with Chinese governmental officials to obtain licenses and curtail governmental investigations of the company's business practices. The SEC seeks permanent injunctive relief and monetary penalties against Li.

In December 2019, the SEC announced it settled FCPA charges against **LM Ericsson**. The SEC alleged that Ericsson bribed officials in Saudi Arabia, China and Djibouti to secure roughly $427 million in business, and that it also violated the FCPA in Vietnam, Indonesia and Kuwait. To settle the allegations, Ericsson agreed to pay more than $539 million in disgorgement and prejudgment interest. Ericsson also agree to pay a $520 million penalty to settle parallel criminal charges brought by the DOJ. Ericsson Egypt plead guilty to conspiracy to violate FCPA provision, and the company agreed to retain an independent compliance monitor for at least 3 years.

In December 2019, the SEC announced that it settled FCPA charges against Tim Leissner, a former **Goldman Sachs Group Inc.** executive. The SEC alleged that Leissner utilized a third-party intermediary to bribe officials in Malaysia and the Emirate of Abu Dhabi in exchange for business. Leissner consented to an order requiring disgorgement of $43.7 million, which is offset by amounts paid pursuant to settlement of a parallel criminal action by the DOJ. Leissner also agreed to be permanently barred from the securities industry.

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