2018 Year in Review

The level of securities class actions filed in US state and federal courts combined reached record levels in 2018, which is at least in part driven by merger objection suits, “event driven” litigation, and traditional securities fraud claims. This summary will discuss 2018 filing trends, as well as provide an overview of recent US Supreme Court decisions that have the potential to impact the liability of directors’ and officers’ (“D&O”) in the United States. Finally, this summary will provide an overview of several of the key cases that came down in 2018 addressing coverage under D&O insurance policies.

FILING TRENDS

Since 2012, litigation initiated against companies and their D&O insurance policies has increased steadily and at times dramatically, year over year through 2017. In 2018, the heightened level of filings continued, due in part to the US Supreme Court’s decision in *Cyan, Inc. v Beaver County Employees Retirement Fund*.[1] Additionally, the overall litigation rate (i.e., the number of securities actions compared to the number of public companies in the US) continues to increase. While this is at least partially due to the fact that the number of publicly traded companies in the US has declined due to a variety of factors, such as mergers and bankruptcies, it is a factor to be mindful of when considering the rate of filings.

Many of the securities actions filed over the past year involved merger objection lawsuits, as well as a fair number of traditional securities class actions. In addition, "event-driven" securities class actions (i.e., securities class actions filed against companies that experience some type of a significant event that has a negative impact on operations) are a continuing and concerning trend. Such litigation now commonly follows corporate announcements regarding such difficulties (and subsequent stock drops) in a variety of areas, including cyber-security breaches, allegations of corporate or director-based sexual harassment or discrimination, wildfire liability, drilling explosions, and even the filing of widespread product liability litigation.

Filings were greatest in New York, Delaware, and California federal courts (in that order), but there were also a sizeable number of filings in New Jersey.[2] Given this backdrop, it is no surprise that D&O liability and the insurance coverage issues presented by litigation arising from same were the subject of several judicial decisions at both the state and federal levels during 2018.

2018 US SUPREME COURT DECISIONS IMPACTING D&O LIABILITY

Two cases decided by the US Supreme Court in 2018 directly impact D&O liability, and as such deserve greater attention. The first of these cases is *Cyan, Inc. v Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (Mar. 20, 2018), in which the Supreme Court decided the question of whether the Securities Litigation Uniform Reform Act of 1998 (SLUSA) stripped state courts of jurisdiction over securities class actions alleging solely violations of the Securities Act of 1933 (the "'33 Act"), and if not whether SLUSA allows defendants to remove such actions to federal court.

The Supreme Court's decision on these issues resolves a split amongst the Circuits regarding the reach of SLUSA's pre-emption. The second important Supreme Court decision decided in 2018 resolves an issue not only relevant to securities class action, but one that will have an impact on all class actions going forward. In *China Agritech, Inc. v Resh*, 138 S. Ct. 1800 (June 11, 2018), the Supreme Court answered the question of whether *American Pipe* tolling applies not only to individual claims, but to successive class actions as well. This review highlights these Supreme Court decisions, as well as discusses a case the Supreme Court will decide during the 2018-2019 term, *Francis v Lorenzo v SEC*, Supreme Court Docket No. 17-1077, 2018 U.S. Lexis 3813. At issue in *Lorenzo* is whether a person who did not make a misrepresentation can, nonetheless, be held liable for same under the securities laws upon a theory of scheme liability.

Cyan, Inc. v Beaver County Employees Retirement Fund

The most anticipated Supreme Court decision in 2018 to bear on D&O liability was the *Cyan* decision. It is worth summarizing the developments of securities-related laws in recent history to fully understand the impact of the *Cyan* decision. The '33 Act, along with the Securities Exchange Act of 1934 (the "'34 Act") were passed in the wake of the 1929 stock market crash to encourage honesty in the sale of securities.

The '33 Act governs the original sale of securities offerings and authorizes both state and federal courts to exercise jurisdiction over lawsuits brought for violations of the act. However, the '33 Act bars the removal of such suits from state court to federal court if plaintiffs initially file their claims in state court. The '34 Act is similar to the '33 Act, but governs the sale of securities on the secondary market. All lawsuits alleging violations of the '34 Act are subject to the exclusive jurisdiction of the federal courts.

In 1995, for purposes of curbing abuses by the plaintiffs' bar in pursing securities class action litigation, Congress passed the Private Securities Litigation Reform Act, or PSLRA. The PSLRA contained both substantive and procedural reforms, but applies only to those securities class actions implicating federal laws. Moreover, while the substantive reforms of the PSLRA apply regardless of jurisdiction, the procedural reforms apply only to cases brought in federal court. To get around the PSLRA restrictions, plaintiffs began filing their securities class actions under state securities laws in state courts.

In response, Congress then passed the Securities Litigation Uniform Standards Act, also commonly referred to as SLUSA. Essentially, SLUSA dictated that certain securities class actions had to be brought pursuant to federal law and could not be brought pursuant to state law. However, a question remained regarding whether SLUSA also required class actions

alleging violations of the ‘33 Act (which as noted above, were allowed to be filed in state court) to be filed solely in federal court. The various Circuits’ decisions on this issue were split, with some finding that SLUSA stripped state courts of jurisdiction over those actions alleging solely violations of the ‘33 Act, while others finding that SLUSA had no such effect on these actions.

In unanimously deciding this issue, the Supreme Court held that SLUSA does not pre-empt a state court’s jurisdiction (as provided for in the ‘33 Act) over cases solely alleging violations of the ‘33 Act. If it was Congress’s intent to strip state courts of jurisdiction over those claims, the Supreme Court noted that Congress would had directly done so, and it has not.

Moreover, the substantive reforms enacted by the PSLRA are still intact, even for cases proceeding in state courts. The Supreme Court also determined that removal to federal court was not allowed for those actions filed in state courts and that solely allege violations of ‘33 Act claims. SLUSA is clear that removal of a securities class action is available only when the alleged securities violations are brought pursuant to state law, but as the Supreme Court noted, the ‘33 Act is a federal law.

As a result of the *Cyan* decision, the Supreme Court has conclusively determined that without Congress taking action, defendants involved in securities actions filed in state court solely alleging violations of the ‘33 Act have no means by which to extricate themselves from that court to have their case heard by a federal court. This matters for a few reasons. First, state court judges are often times less familiar, not only with securities cases generally, but also class actions brought under the ‘33 Act.

Further, the *Cyan* decision will likely result in defendants having to concurrently defend securities class actions brought in both federal and state courts. But perhaps even more importantly, defendants lose the protections the PSLRA procedural reforms provide in federal court actions. This could result in merits discovery beginning earlier in the litigation, and it may be more likely that a case is allowed to be proceed beyond the motion to dismiss stage, both of which raise the cost of defending these actions not only for the insureds, but their insurers, as well.

Finally, because state court filings are more difficult to track than federal court filings, the reported rate of securities class action filings will become somewhat more difficult to track and could vary more considerably between the various outlets that regularly report on such filings.

China Agritech, Inc. v Resh

Before discussing the Supreme Court's recent decision in *China Agritech, Inc. v Resh*, it is important to understand the case decided by the Supreme Court in 1974 captioned *American Pipe & Construction Co., v Utah*, 414 U.S. 538 (1974). That case established that the timely filing of a class action tolls the applicable statute of limitations for all persons encompassed by the class complaint. This is often referred to as "*American Pipe* tolling."

Additionally, the Supreme Court held in *American Pipe* that, because the statute of limitations is tolled, members of a class that fail to obtain class certification can either:

- timely intervene as an individual plaintiff in the still-pending (albeit non-certified) action, or
- bring their own action rather than intervene.

What remained unclear to some after the *American Pipe* decision was whether the tolling extended to subsequently filed class actions. Specifically, Circuits were split in their decisions as to whether *American Pipe* tolling should be granted in those circumstances where the original purported class action failed to obtain class certification, and a class member of the failed class timely filed a separate action thereafter, but filed it as a purported class action. As such, the Supreme Court agreed to address the issue in *Resh*.

The *Resh* case involved two purported securities class actions that were filed within the statute of limitations, each of which failed to obtain class certification. A third class action was then filed a year and a half after the statute of limitations had run. The district court dismissed the third class action as untimely, and the plaintiffs appealed. The Ninth Circuit Court of Appeals reversed, holding that "permitting future class action named plaintiffs, who were unnamed class members in previously uncertified classes, to avail themselves of *American Pipe* tolling would advance the policy objectives that led the Supreme Court to permit tolling in the first place."

Additionally, the Ninth Circuit reasoned that applying *American Pipe* tolling to successive class actions would cause no unfair surprise to defendants and would promote economy of litigation by reducing incentives for filing protective class suits during the pendency of an initial certification motion.

In reversing the Ninth Circuit's decision in *Resh*, the Supreme Court held that *American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier and timely filed class action because the efficiency and economy of litigation that supports tolling in connection with individual claims is not present for successive and untimely class actions. In other words, once a class action has been filed, it makes sense to delay the filing of individual actions by members of the purported class until it is known whether the class will be certified.

However, the Supreme Court noted the opposite is true for purported class actions. Courts encourage all class actions to be filed as soon as possible, as the court will then need to decide which plaintiff will act as the lead plaintiff after assessing from all potential class representatives who the best plaintiff is based on their knowledge of, and issues involved, in the case.

The *Resh* decision should have a positive impact on the exposure presented by securities class actions going forward (as well as other types of class action litigation). While the decision may encourage multiple parties to initially file a class action to address the same wrong, only one action should ultimately be allowed to move forward to represent all class members. Further, the *Resh* decision should give some piece of mind to Companies and their D&Os that once the statute of limitations has run, no additional class actions will be filed against them involving the same circumstances.

UPCOMING SUPREME COURT CASE TO WATCH

Francis v Lorenzo v Securities and Exchange Commission

In its upcoming 2018 to 2019 term, the Supreme Court is expected to render its decision in *Francis v Lorenzo v Securities and Exchange Commission*, which will decide whether a theory of "scheme liability" can be used to hold someone liable under the securities laws

for the misrepresentations of another. In this case, the Securities Exchange Commission (SEC) prosecuted Lorenzo, the head of investment banking at Charles Vista LLC, for fraud after he sent out communications to investors that contained misrepresentations. Specifically, the communications, which were intended to entice investors to buy bonds in an energy company, failed to include material information about the company's asset value, which was significantly lower than the company had previously reported.

There was no evidence that Lorenzo drafted or even read the communications he issued to potential investors. The communications themselves had been prepared by Lorenzo's boss. Despite these facts, the SEC prosecuted Lorenzo for fraud in violation of the '33 Act and the '34 Act. The administrative law judge overseeing the case concluded that, although Lorenzo did not draft or read the communications, he nonetheless violated the securities laws, acting with the intent to deceive and defraud. Lorenzo's appeals eventually took his case to the D.C. Circuit Court, which held in a 2 to 1 decision that Lorenzo's actions did violate the '33 Act and the '34 Act.

The D.C. Circuit Court's decision represents a split amongst the Circuits, as the Second, Ninth and the Eighth Circuits have all held that something more than just a fraudulent statement is necessary to find liability under a theory of scheme liability. As such, the Supreme Court granted Lorenzo's petition for writ of certiorari. In that petition, Lorenzo argues that the D.C. Circuit's holding is in contravention of the Supreme Court's decision in *Janus Capital Group, Inc. v First Derivative Traders*, 564 U.S. 135 (2011), which held that only the "maker" of a fraudulent statement may be held liable for that misstatement under Section 10(b) of the '34 Act. As such, the question presented to the Supreme Court is "whether a misstatement claim that does not meet the elements set forth in *Janus* can be repackaged and pursued as a fraudulent scheme claim."

Depending on how the Supreme Court decides this question, it could lead to more claims being asserted against D&OS seeking to recover under a theory of fraudulent scheme liability.

SUMMARY OF 2018 D&O INSURANCE CASES

In addition to the Supreme Court cases discussed above addressing D&O liability, there were several decisions in the US focusing on coverage issues raised in the context of D&O policies. A summary of some of the more interesting and relevant cases is provided below:

INSURED CAPACITY

- *Security National Ins. Co. v H.O.M.E., Inc.*, 312 F. Supp. 3d 777 (D.N.D. 2018).

Applying North Dakota law, the United States District Court of North Dakota held there was no coverage under a D&O policy for an action brought against the President and Director of the insured company who was sued both in his insured capacity as a D&O of the company, as well as in his non-insured capacity as a lawyer who provided advice to the plaintiffs on an independent contract basis.

The insuring agreement to the D&O policy provided coverage for claims alleging a "management wrongful act" which was defined as "any actual or alleged . . . breach of duty by an insured person acting solely in their capacity as . . . director, officer . . . or employee of the company." The court noted that all of the claims alleged against the insured arose out of the same conduct and were brought against him in his capacity as both a D&O and an attorney. Because the defendant was not sued solely within his insured capacity of a D&O of the company, as was required under the policy, the court found against the insured on coverage and granted summary judgment to the insurer

- *Goggin v Nat'l Union Fire Ins. Co.*, 2018 Del. Super. Lexis 1533 (Super. Ct. Nov 30, 2018).

Applying Delaware law, the court held there was no coverage for certain former directors where the allegations in the underlying complaint arose out of their involvement with uninsured entities. The underlying D&O policy excluded coverage for claims ". . . arising out of, based upon or attributable to any actual or alleged act or omission of an Individual Insured serving in any capacity, other than as an Executive or Employee of a Company. . . ."

The court held that the exclusion applied where claims against the former directors would not have arisen but for their creation of certain uninsured entities in an effort to control the insured and defraud its creditors for their own benefit.

- *Gleason v Markel Am. Ins. Co.*, 2018 U.S. Dist. Lexis 11608 (E.D. Tex. Jan. 24 2018).

Applying Texas law in the context of a duty to defend D&O policy, the court held that the underlying complaint potentially triggered coverage where the allegations were not limited to the directors' actions as sellers of shares of the insured entity. Further, the court held that the definition of "Wrongful Act" in the policy did not explicitly state that a "Wrongful Act" occurs when the directors "act solely in their official capacity."

Nonetheless, the court held the D&O policy's broadly worded securities exclusion applied to preclude coverage for the underlying complaint. That provision excluded 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." In light of this language, the court held that a "claim need only bear an incidental relationship to the described conduct for the exclusion to apply."

DISGORGEMENT

- *In Re TIAA-CRFF Ins. Appeals*, 192 A.3d 554 (Del. 2018).

Applying New York law, the Delaware Supreme Court held that the insured could receive indemnification from its insurers for disgorgement claims made by investors in underlying class actions where, among other things, the insured denied wrongdoing in the underlying actions and no court had found that the insured had obtained ill-gotten gains. As such, the court held that New York public policy prohibiting coverage for disgorgement did not apply to the circumstances of the underlying case.

- *J.P. Morgan Sec., Inc. v Vigilant Ins. Co.*, 2018 NY Slip Op 06146, No. 600979/2009 (1st Dept. Sept. 20, 2018).

Applying New York law, the New York Appellate Division, First Department, held that a $140 million "disgorgement" payment ordered by the SEC arising from alleged violations of securities laws constituted an uncovered "penalty" that did not constitute a covered "loss" within the definition of a primary professional liability policy. In so holding the Appellate Division agreed with the carriers that *in Kokesh v Securities Exchange Commission*, 137, S.Ct. 1635 (2017), the US Supreme Court "conclusively defined the nature of the SEC disgorgement remedy as a penalty, not a loss."

DEFINITION OF CLAIM

- *Astellas US Holdings, Inc. v Starr Indemnity and Liability Co.*, 2018 U.S. Dist. Lexis 89725 (N.D. Ill., May 30, 2018).

The United States Department of Justice ("DOJ") issued a subpoena to the insured demanding the production of documents as part of the DOJ's investigation into whether the insured violated certain laws by making contributions to independent charity patient assistance programs. Additionally, the insured entered into a tolling agreement with the DOJ, while it investigated. The insured then tendered the subpoena to its D&O carriers seeking coverage for the defense costs it incurred in responding to the subpoena.

The primary D&O carrier took the position that the subpoena did not constitute a claim for a Wrongful Act and denied coverage. The two excess D&O carriers argued that the primary policy had not been exhausted, and as such, their obligations to pay were not triggered. The insured filed a declaratory judgment action.

Applying Illinois law, and in finding that the primary D&O policy provided coverage for the subpoena, the court focused on the definition of claim, which included a written demand for non-monetary relief. The court determined that the subpoena "demanded" information, in that it required the insured to produce documents or face court-imposed consequences. As such, the court concluded this was a "demand for non-monetary relief" under the definition of claim.

Moreover, the definition of claim was also met under that portion that defined a claim as a "written request to toll or waive the applicable statute of limitations relating to a potential claim . . . for a Wrongful Act." The court looked to the tolling agreement itself, which informed the insured that the DOJ was conducting both a criminal and civil investigation into the insured's possible violations of certain laws, and that the insured could be charged with certain violations or offenses. Based on these facts, the court determined that the definition of claim was also met by the tolling agreement since that constituted a written request to toll the statute of limitations, which related to a potential claim for a Wrongful Act.

- *Millenium Labs. v Allied World Assur. Co.*, 2018 WL 1179601 (9th Cir. Mar. 7, 2018).

Applying California law, the Ninth Circuit Court of Appeals reviewed the definition of "claim" under a D&O policy as it pertained to an investigation by the Department of Justice ("DOJ"). In reviewing the policy wording, the Ninth Circuit held that definition of "claim" was "'concerned with the temporal certainty of the 'claim,' rather than with 'it's scope.'" Thus, the court held, "the [DOJ] investigation is properly viewed as multiple claims, one for each alleged 'wrongful act,' 'error, or omission' by an insured that the DOJ investigated."

After analyzing that issue, the court held that five of the "claims" by the DOJ were related to a prior lawsuit, and thus subject to the policy's specific litigation and/or pending and prior litigation exclusions. With regard to the remaining two "claims", the court held that the insured did not meet its burden to establish that those "claims" were made before the expiration of the policy period.

- *Jalbert v Zurich Servs. Corp.*, 325 F. Supp 3d 212 (D. Mass. 2018).

Applying Massachusetts law, the court held that an SEC formal order of investigation constitutes a "claim" under the policy at issue where such definition included "a formal regulatory proceeding (civil, criminal or administrative) against or formal investigation of an Insured." As such, coverage was triggered under a previous policy because the SEC investigation was a "claim" first made during the earlier policy period.

RELATED CLAIMS

- *Cushman & Wakefield, Inc. v Illinois Nat'l Ins. Co.*, 2018 U.S. Dist. LEXIS 67523 (N.D. Ill. April 20, 2018).

Several claims were brought against the insured alleging it used an improper appraisal method when appraising several properties for the purpose of inflating the property valuations, which resulted in higher earned fees. In applying New York law, the court analyzed the issue of whether the claims should be treated as related or as separate under the "sufficient factual nexus" test under certain professional liability policies issued to the insured.

The court determined that the multiple claims brought against the insured over a period of three years were all related for purposes of determining which policy period was proper. The court noted that all of the claims contained overlapping factual allegations arising from similar circumstances. Specifically, they all involved the same alleged course of conduct during the same time period and involved the same properties.

Further, the plaintiffs in each of the actions alleged that they were harmed in connection with the appraisals, all of which used the same improper method, and that the appraisals were misleading and artificially inflated the properties' values. Contrary to arguments asserted by the insured and some of the insurers, the court stated that the claims need not involve the same parties, legal theories, wrongful acts or requests for relief in order to be related.

DUTY TO DEFEND

- *Woodspring Hotels LLC v National Union Fire Ins. Co. of Pitts. PA*, 2018 De. Super. Lexis 186 (May 2, 2018).

In this coverage dispute, a Delaware court, applying Delaware and Kansas law, held that the D&O carrier had a duty to defend both the insured entity and an individual D&O in connection with a lawsuit asserting the insureds had misappropriated confidential and competitively sensitive information from a competitor, as well as violation of trade secrets laws, tortious interference with contract and business expectancy and violation of the federal computer fraud and abuse act.

The D&O carrier took the position that an exclusion for the misappropriation of trade secrets in the policy precluded coverage for the lawsuit, but it agreed to provide a defense to the insured individual under a reservation of rights. In finding that the insured entity was also entitled to a defense under the duty to defend policy, the court noted that the count for violations of the federal computer fraud and abuse act was not subject to any policy exclusions, as it did not "rise or fall on whether a trade secret was involved."

While the court recognized that the gravamen of the lawsuit alleged the misappropriation of trade secrets, it determined that a violation of the federal computer fraud and abuse is broader than a misappropriation of trade secrets claim. Because the potential for liability existed as to that claim, even if remote, the duty to defend the insured entity was triggered.

THE FRAUD EXCLUSION

- *Arch Ins. Co. v David H. Murdock*, 2018 Del. Super. Lexis 96 (March 1, 2018).

In this coverage action, the insureds sought coverage for a derivative action that alleged that the D&Os had engaged in a process to manipulate the company's stock price so that an individual director could acquire the stock at a lower price for purposes of taking the company private. The vice chancellor overseeing the derivative case made repeated references to certain D&Os "fraud" and "fraudulent activity." He also found against certain D&Os and assessed liability in excess of US$148 million.

That action eventually settled and the insureds sought reimbursement from their D&O carriers. In a subsequent declaratory judgment action, the D&O carriers argued that the findings of fraud by the vice chancellor prohibited the insurers from reimbursing the Insureds for the settlement amount. However, the Delaware state court, applying Delaware law, held that there was no precedent for the insurers' position that a corporation could not obtain D&O insurance that covers a breach of loyalty claim based on fraud.

Moreover, Delaware public policy does not "clearly prohibit" insurance companies from insuring fraud. Additionally, the court noted that Delaware allows insurers to cover punitive damages, which the court noted are awarded for willful or wanton conduct. The court then reasoned that because the fraud at issue was reckless or knowing conduct, and Delaware allows for the insurance of punitive damages, which are essentially awarded as a result of the same conduct, it determined that the insurers' indemnification of the settlement payment was not in violation of Delaware public policy.

THE PROFESSIONAL SERVICES EXCLUSION

- *Beazley Ins. Co., Inc. v ACE American Ins. Co.*, 800 F.3d 64 (2nd Cir. Jan. 22, 2018).

The court decided a coverage dispute between the insured's E&O carrier and two of its D&O carriers. The D&O carriers had both denied coverage under the professional services exclusion of the primary D&O policy for a lawsuit brought against the insured, NASDAQ, by investors related to technical difficulties in executing the IPO for Facebook, Inc., which resulted in the investors' trades not being performed properly.

The professional services exclusion precluded coverage for "any Claim . . . by or on behalf of a customer or client of the Company . . . arising out of . . . the rendering of professional services." The E&O carrier paid its limits to settle the lawsuit, then filed suit against the two D&O carriers. However, finding that the professional services exclusion applied, the District Court granted summary judgment to the D&O carriers. The E&O carrier appealed. In affirming the decision of the district court, the Second Circuit (applying New York law) held that the plaintiffs were "customers" of NASDAQ within the meaning of the professional services exclusion, and that the complaint fell within the professional services exclusion because the plaintiffs could not have prevailed without establishing their injuries were caused by NASDAQ's failure to properly process their trades.

- *Hotchalk, Inc. v Scottsdale Ins. Co.*, 2018 U.S. App. Lexis 14884 (9th Cir. June 4, 2018).

A company tendered a *qui tam* action to its D&O carrier for coverage. The *qui tam* action alleged that the insured violated federal regulations in connection with the enrollment of students who received federal financial aid and caused both the students, as well as the universities with which the insured did business to submit false claims to the federal government in violation of the False Claims Act. The D&O carrier denied coverage, relying on the professional services exclusion. The District Court agreed and granted the D&O carrier's motion for judgment on the pleadings. The insured appealed to the Ninth Circuit Court of Appeals, which affirmed the District Court's decision under California law.

In so doing, the Ninth Circuit noted that the claims against the insured alleged that it had caused false claims to be submitted to the federal government, thereby defrauding it. The insured's liability derived from the fact that its professional services caused ineligible students and universities to submit financial aid claims to the federal government. As such, the Ninth Circuit held that the insured's liability arose out of the professional services it provided, and thus was excluded from coverage.

THE PRIOR ACTS EXCLUSION

- *Certain Underwriters at Lloyd's of London v The Federal Deposit Insurance Corp.*, 723 Fed. Appx. 764 (11th Cir. Jan. 23, 2018), cert. denied. 201 L. Ed. 2d 296, 2018 U.S. Lexis 3305 (May 29, 2018).

During the housing bubble, and prior to the June 2008 inception of the D&O policy period at issue, a bank made loans through its Community Development Lending Division ("CDLD") pursuant to unsound lending practices. These unsound lending practices triggered regulatory investigations. Eventually, the bank foreclosed on many of the properties the loans were used to purchase. Instead of selling the foreclosed properties, which were referred to as Other Real Estate Owned ("OREO") properties, certain bank D&Os instituted a plan to invest in and renovate the properties.

This plan was authorized by regulators in early 2008 at the time the bank had a rating of "fundamentally sound." Although regulators changed the bank's rating in September 2008 to "failing or imminently failing," the D&Os continued to invest in the OREO properties. The bank failed in March 2009 and the FDIC assumed control. The FDIC then filed an action against the D&Os seeking to recover for the "CDLD and OREO Wrongful Acts." The D&O carrier denied coverage, arguing the lawsuit was excluded by the prior acts exclusion, which precluded coverage for interrelated wrongful acts deemed to have first occurred prior to the D&O policy's inception date.

In affirming the District Court's decision that the exclusion did not apply to the "OREO Wrongful Acts," the Eleventh Circuit Court of Appeals (applying New York law) held that, although the wrongful acts related to the CDLD loans occurred prior to the inception of the D&O policy, those acts were distinct from the Wrongful Acts related to the investments in the OREO properties. Moreover, the D&O carrier did not argue, nor could it prove, that the "OREO Wrongful Acts" of investing money into the OREO properties after the bank's rating was downgraded arose out of the improper CDLD loan practices.

SPECIFIC/SPECIAL EVENT EXCLUSION

- *Emmis Communic'ns Corp. v Ill. Nat'l Ins. Co.*, 323 F. Supp. 3d 1012 (S.D. Ind. 2018).

In this coverage dispute, a D&O carrier denied coverage for a shareholder suit, relying on a "Special Event Exclusion" that precluded coverage for any claim "in connection with" any events listed in the exclusion or "the prosecution, adjudication, settlement, disposition, resolution or defense of" the listed events or any claims arising from those events, or "any Claim alleging, arising out of, based upon, attributable to or in any way related directly or indirectly, in part or in whole, to an Interrelated Wrongful Act."

The shareholder lawsuit at issue was filed after the company acquired a sufficient amount of the company's stock to ensure that amendments to the company's treatment of its Preferred Stock would pass. The shareholders alleged in their complaint that the amendments to the treatment of Preferred Stock were in violation of federal and state securities laws. The events listed in the Special Event Exclusion were related to events that took place two years prior, and involved the company's efforts to acquire a sufficient amount of stock for purposes of having sufficient voting power to change the treatment of the Preferred Stock.

The initial complaint filed in connection with the shareholder lawsuit contained references to these events, but the second amended complaint did not. The court determined that the D&O carrier could not rely on the allegations referring to the excluded events for purposes of denying coverage. The court held that the allegations involving those events as made in the shareholder lawsuit were mere "window dressing" rather than "operative facts" necessary to support the shareholders' legal claims, and that this conclusion was supported by the fact that those allegations were dropped from the second amended complaint. Moreover, the allegations did not constitute "wrongful acts," but instead were goals by the company to acquire stock.

Further, the court held that the purpose of the exclusion at issue was to exclude claims "seeking to hold the insureds liable for the actions or omissions that are logically connected to" the listed events.

INSURED V INSURED EXCLUSION

- *Security National Ins. Co. v H.O.M.E., Inc.*, 312 F. Supp. 3d 777 (D.N.D. 2018).

Applying North Dakota law, the court held that the Insured v Insured exclusion barred coverage for an action brought against a D&O of the insured company by his sister, who was a director of a subsidiary bank of the insured company, and thus an insured under the policy.

The Insured v Insured exclusion precluded coverage for all loss in connection with any claim by an insured person. Despite the fact that the claims were also brought by two others who were not insured persons did not matter, according to the court, because the policy did not contain an allocation provision for covered and uncovered claims. As the sister was a plaintiff in connection with all claims and was an insured person under the policy, the entire complaint was precluded from coverage under the Insured v Insured policy.

CONTRACTUAL LIABILITY EXCLUSION

- *Spec's Family Ltd. v Hanover Ins. Co.*, 2018 U.S. App. Lexis 17246 (5th Cir. July 23, 2018).

A claim was brought against a retailer who accepts credit card payments after it was hacked, resulting in numerous fraudulent transfers. The claim was initiated by the company responsible for processing the credit card payments under a Merchant Agreement it entered into with the retailer. It alleged that, not only was the retailer in breach of the Merchant Agreement, but it was also negligent in failing to comply with the Payment Card Industry Data Security standards (PCIDSS), among other things.

The D&O carrier denied coverage relying on the contractual liability exclusion in the policy, arguing that the loss being sought directly or indirectly arose out of the Merchant Agreement. In reversing the district court's grant of judgement on the pleadings in favor of the D&O insurer, the Fifth Circuit Court of Appeals, applying Texas law, held that given the allegations asserted in the claim, it was premature to enter judgment on the pleadings based on the contractual liability exclusion.

The court pointed to, among other things, allegations that the retailer had been negligent in not meeting the PCIDSS requirements, which could be separate and apart from the alleged losses for breach of the Merchant Agreement. Thus, the Fifth Circuit remanded the case to the district court for further proceedings.

SECURITIES EXCLUSION

- *Gleason v Markel Am. Ins. Co.*, 2018 U.S. Dist. Lexis 11608 (E.D. Tex. Jan. 24 2018).

Applying Texas law in the context of a duty to defend D&O policy, the court held the D&O policy's broadly worded securities exclusion applied to preclude coverage for the underlying complaint where the directors agreed to sell their interest in the insured entity to a separate company. That provision of the D&O policy excluded 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." In light of this language, the court held that a "claim need only bear an incidental relationship to the described conduct for the exclusion to apply."

ENDNOTES

[1] Cornerstone Research, "Securities Class Action Filings: 2018 Year In Review" (Feb. 4, 2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.

[2] Kevin LaCroix, "Securities Suit Filings Continue at Heightened Pace in 2018," THE D&O DIARY (Jan. 6, 2019), https://www.dandodiary.com/2019/01/articles/securities-litigation/securities-suit-filings-continued-heightened-pace-2018/.

FURTHER INFORMATION

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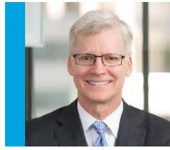
AUTHORS

Jennifer Quinn Broda
Of Counsel, Chicago
t +1 312 800 5039
jennifer.broda@kennedyscmk.com

Eric Scheiner
Partner, Chicago
t +1 312 800 5051
eric.scheiner@kennedyscmk.com

THE D&O TEAM



John Blancett
Partner, New York
t +1 646 625 3956
john.blancett@kennedyscmk.com

Jennifer Quinn Broda
Of Counsel, Chicago
t +1 312 800 5039
jennifer.broda@kennedyscmk.com

Christopher Carroll
Partner, Basking Ridge
t +1 908 848 1250
christopher.carroll@kennedyscmk.com

Meg Catalano
Partner, Basking Ridge
t +1 908 848 1222
meg.catalano@kennedyscmk.com

Mark Chudleigh
Partner, Bermuda
t +1 441 278 7160
mark.chudleigh@kennedyslaw.com

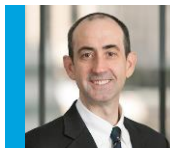
Mark Dessi
Partner, New York
t +1 646 625 4004
mark.dessi@kennedyscmk.com

Matthew Ferguson
Partner, New York
t +1 646 625 4017
matthew.ferguson@kennedyscmk.com

Alex Guillamont
Partner, Miami
t +1 305 371 1111
alex.guillamont@kennedyscmk.com

Christopher Novak
Partner, New York
t +1 646 625 4043
christopher.novak@kennedyscmk.com

Eric Scheiner
Partner, Chicago
t +1 312 800 5051
eric.scheiner@kennedyscmk.com



William Brennan
Associate, New York
t +1 646 625 4036
william.brennan@kennedyscmk.com

Diana Karnes
Associate, Chicago
t +1 312 800 5050
diana.karnes@kennedyscmk.com

Josh Levy
Associate, Miami
t +1 305 371 1111
josh.levy@kennedyscmk.com

Thomas Orofino
Associate, New York
t +1 646 625 4024
thomas.orofino@kennedyscmk.com

Nicole Putnam
Associate, New York
t +1 646 625 3991
nicole.putnam@kennedyscmk.com

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