Aon Risk Solutions

2013 Year in Review

Legal News and Developments in Executive Liability

Volume 10

Risk. Reinsurance. Human Resources.

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2013 Year in Review

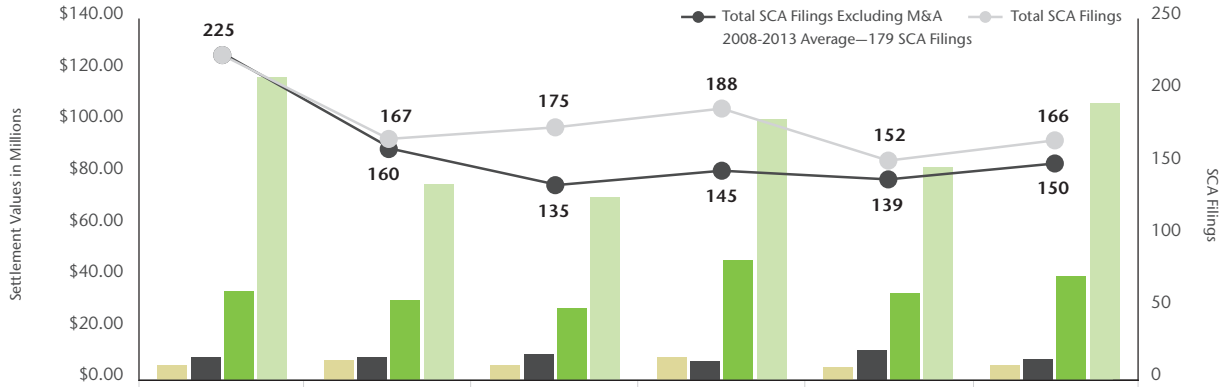
Aon Financial Services Group (FSG) is pleased to present its tenth annual Year in Review publication. In addition to an active year of executive liability exposures, claims, and coverage litigation, FSG tracked the efforts of the Securities and Exchange Commission (SEC) to flex its rulemaking and enforcement muscles, including the adoption of tougher policies and practices which included the insistence of more "admissions" in SEC settlements.

In what proved to be a very active year for regulatory investigations, the SEC filed 686 proceedings, down from the 734 it filed in its fiscal year ending September 20, 2012. The SEC also obtained orders in its fiscal year 2013 requiring the payment of all-time record high $3.4 billion in disgorgement and penalties. In the past two years, the SEC has obtained orders for approximately $6.4 billion.

The number of federal shareholder class action (SCA) filings in 2013 represented a slight increase in frequency over 2012. According to Stanford Law School Securities Class Action Clearinghouse (Stanford), there were 166 federal shareholder class action suits filed in 2013, slightly more than the 152 actions filed in 2012 (but well below the historic average of approximately 190 per year).

While merger and acquisition (M&A) suits have historically been filed in state court, the recent trend of M&A objection suits being filed in federal court continued in 2013, with 16 of the 166 SCA filings representing merger objection litigation. As companies continue to search for growth via acquisition, we anticipate significant M&A activity in 2014; however, we are encouraged by a number of recent decisions by the Delaware Chancery Court that lead us to believe multi-jurisdictional litigation and certain disclosure-only settlements may be less lucrative in the future. It remains to be seen if these rulings in Delaware, which are summarized herein, will be effective in discouraging the infinitely creative plaintiffs' bar from filing such lawsuits in connection with M&A transactions.

Frequency and Severity of Federal Shareholder Class Actions
2008–2013



	2008	2009	2010	2011	2012	2013
Num. of Settlements	108	103	105	78	69	89
$100M+ *	6	8	6	9	5	6
Median *	$9.00	$9.00	$10.00	$7.50	$11.63	$8.10
Average **	$34.36	$31.12	$28.15	$45.67	$33.70	$40.48
St. Dev **	$117.32	$76.09	$70.96	$101.17	$82.66	$107.36

** Includes settlements of $1B or greater*
*** Excludes settlements of $1B or greater*

Source: Aon Financial Services Group; Filing data courtesy of Stanford Law School Securities Class Action Clearinghouse

Note: Settlement information generally reflects settlements as of the date a settlement is announced. As additional parties settle and settlements become final, settlement values and dates occasionally change. Aon FSG adjusts settlement figures in this chart to reflect these changes.

Shareholder class action severity for 2013 produced some interesting statistics. The average shareholder class action settlement jumped substantially from $33.7 million in 2012 to $40.48 million in 2013. This settlement value is a substantial increase as compared with an average settlement in 2010 of $28.15 million. Interestingly, the median settlement in 2013 of $8.1 million dropped dramatically from $11.63 million (the highest median settlement value ever) in 2012.

The amount of coverage litigation involving executive liability insurance in 2013 remained high. As we have previously observed, coverage litigation involving excess insurers after primary carriers have exhausted their limits in a claim continues to increase. Due to increases in claims severity and softness of excess rates in this pricing environment, we believe this pattern will continue.

We hope you enjoy the 2013 *Year in Review*. As always, we look forward to reporting the events and trends of 2014. Thank you for your continued interest and support in our report.

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January 2013

Corporations should focus on "prevention through risk assessment of vulnerable processes, and effective risk mitigation through education and checks and balances; detection through internal reporting and internal forensic auditing; and early response before the problems metastasize."

General News

Sectoral Scandals Raise Profound Issues for Business Leaders

In a Harvard Business Review article by Ben Heineman, Jr. titled *Why Are Some Sectors (Ahem, Finance) So Scandal-Plagued?*, Heineman highlights the significant increase in the size of settlements, fines, and penalties over the past 25 years for corporations found guilty of wrongdoing, as well as scandals that seem to plague certain industries and business leaders. For example, consider the recent agreement by ten major banks to pay $8.5 billion as a result of deficient mortgages and foreclosure processes, the pharmaceutical industry's substantial payments for off-label marketing under the False Claims Act, or the introduction of complex accounting rules concerning derivatives which led to costly restatements for many corporations, most notably Fannie Mae's $10.8 billion restatement. The financial sector in particular has been subjected to the most substantial and highly visible settlements and penalties, such as the aforementioned mortgage improprieties settlement, as well as a DOJ settlement by HSBC in which it agreed to pay $1.9 million for money laundering, and a $100 million fine incurred by a UBS Japanese subsidiary for manipulating the London Interbank Offered Rate (LIBOR). According to Heineman, "[t]hese sectoral scandals raise profound issues for business leaders: in a highly competitive global economy, in which some sectors are flooded with money, how do you assess sector-wide integrity risks and achieve a culture of corporate accountability before, not after, bad behavior occurs?" Heineman suggests these scandals have resulted in "serious societal consequences," such as "injuring homeowners, supporting drug cartels and state sponsors of terrorism, [and] rigging interest rates used in trillions of dollars of transactions across the globe." Heineman believes the lesson to be learned by CEOs and boards of directors is to "follow the money," noting that "in all of these scandals, there has been a burgeoning honey-pot of funds which have tempted mid-level employees to cut corners dramatically in competitive businesses: billions (or trillions) in home loans, drug money or LIBOR rates." Corporations should focus on "prevention through risk assessment of vulnerable processes, and effective risk mitigation through education and checks and balances; detection through internal reporting and internal forensic auditing; and early response before the problems metastasize."

... "[t]hese sectoral scandals raise profound issues for business leaders: in a highly competitive global economy, in which some sectors are flooded with money, how do you assess sector-wide integrity risks and achieve a culture of corporate accountability before, not after, bad behavior occurs?"

SEC Issues Wells Notice Relating to Social Media Communication

An article posted by Holly Gregory, a corporate partner at Weil, Gotshal & Manges, LLP (Weil), examines the application of securities laws to social media communications. The post is based on an alert by Christopher Garcia and Melanie Conroy of Weil. The article explains that the Securities and Exchange Commission (SEC) recently issued, for the first time, a Wells Notice based on a social media communication. The Wells Notice identified potential violations of the Regulation Fair Disclosure (Reg FD) relating to certain statements made by a CEO in a Facebook post. Under Reg FD, an issuer may not disclose material nonpublic information to certain groups, either intentionally or unintentionally, without disclosing the same information to the entire marketplace. This market disclosure must either be made through "filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public." As explained in the article, "the SEC has issued no guidance on whether social media channels can satisfy the disclosures requirements of Reg FD, although its Staff has suggested that companies look to a 2008 SEC interpretive release when considering the FD issues raised by social media." The SEC explained in its 2008 guidance concerning the use of company websites to disseminate information to investors that the "public" nature of company website disclosures would turn on "whether and when: 1) a company web site is a recognized channel of distribution, 2) posting of information on a company web site disseminates the information in a manner

making it available to the securities marketplace in general, and 3) there has been a reasonable waiting period for investors and the market to react to the posted information." The article explains that the first element of the SEC's analysis will turn on whether the company has sufficiently alerted the market to its disclosure practices. "Reg FD-compliant social media practices (if they exist) will likely require: notes in all SEC filings and news releases that the issuer discloses information through social media avenues; prominent links and website explanations for social media accounts; and a regular pattern of accurate and accessible usage." Since the SEC has yet to offer formal guidance concerning the use of social media to communicate with the investing public, the outcome of the SEC's investigation will prove instructive. In the meantime, the authors suggest that directors familiarize themselves with how their companies use social media, including whether social media is used for marketing, customer relations, or any other purpose and ask senior management whether the company has updated or adapted its Reg FD compliance policy to address such usage. We will closely monitor and provide updates, when available, of SEC guidance on social media disclosures.

Cases of Interest

Contract Exclusion Precludes Coverage for Other Claims Arising from Alleged Breach

The insured, a student loan provider, noticed claims under its D&O policy that were made against it arising from its cancellation of a "bonus program" whereby borrowers would receive an interest rate credit on their loans following timely payment. The borrowers alleged the insured breached its contract as well as committed certain statutory violations under state consumer fraud and deceptive trade practices laws. The insurer denied coverage for some of the lawsuits citing the policy's contract exclusion, but provided a defense for others that included both contract and statutory claims. The carrier, however, reserved its rights to seek recoupment of any defense fees paid if it later turned out that no coverage was available. The policy provided that coverage was excluded for any loss "based upon, arising out of, or attributable to liability of the Company under any contract or agreement." The policy also expressly provided that "to the extent that it is finally established that any such Defense Costs are not covered under this Policy, the Insureds ... agree to repay the Insurer such Defense Costs." During the settlement process, the carrier notified the insured that no coverage would be available as the settlement reflected an attempt by the insured to satisfy its contractual obligations, which was excluded. The insured initiated coverage litigation and the insurer sought recoupment of defense costs paid. The court first decided the insured's claim fell within the insuring clause as the claims were for alleged "wrongful acts" and otherwise fell within the grant of coverage. It noted that any argument that common law prohibited coverage for breach of contract claims was inapplicable because statutory claims were also alleged. However, the court did find that the contract exclusion precluded coverage for the claims in their entirety. The court interpreted the phrase "arising out of" broadly, meaning "originating from, having its origins in, growing out of or flowing from" a contract, as well as "causally connected with." The court found the plaintiffs all had contractual relationships with the insured based on the student loan agreements and that the claims involving the bonus program could only occur because of that relationship. The court also noted the exclusion used the term "liability...under a contract" instead of a "breach of contract." This language precluded any argument that the exclusion only applied to the actual breach. Finally, the court found the insured was compelled to return the amounts paid in defense. The policy unambiguously provided for the return of such amounts and the carrier expressly noted this provision in its previous communications with the insured. This precluded any argument that such claw back was prohibited by state law. *Northstar Educ. Fin., Inc. v. St. Paul Mercury Ins. Co. and Phila. Indem. Ins. Co.*, 2013 Minn. App. Unpub. LEXIS 32 (Minn. Ct. App. 2013).

The court interpreted the phrase "arising out of" broadly, meaning "originating from, having its origins in, growing out of or flowing from" a contract, as well as "causally connected with."

Insured v. Insured Exclusion Inapplicable to FDIC Acting as Receiver

This coverage dispute arose after the Federal Deposit Insurance Corporation (FDIC) assumed control of an insured's operations and brought suit against its former directors, officers and employees for their role in the bank's failure. The FDIC estimated losses of approximately $330 million due to the gross negligence in approving certain loans. Individuals named as defendants in the FDIC suit sought coverage under a D&O policy and its insurer filed this action to determine its obligations under the policy and argued coverage was barred by the insured versus insured (IvI) exclusion, based on the damages sought not falling within the policy's definition of loss and that certain claims were based on conduct subsequent to expiration of the policy. Upon examination of the IvI exclusion, the court found its language ambiguous since the FDIC occupied multiple roles and was not limited to the duties which other receivers or conservators of a failed bank serve, specifically noting its duty to recover losses suffered by the Deposit Insurance Fund in addition to a bank's depositors, creditors and shareholders. The FDIC also persuaded the court that ambiguities existed in the definition of

loss since the exclusion applicable to losses from loans did not clearly exempt tortious conduct which formed the basis of the FDIC's claims against the insured's former directors, officers and employees. With respect to the insurer's argument that certain claims arose from conduct following expiration of the policy, the court agreed and dismissed those claims. Any claims related to conduct prior to the policy's expiration, however, survived dismissal. *Progressive Cas. Ins. Co. v. FDIC, as receiver of Omni Nat'l Bank, et al.*, 12-CV-1103 (N.D. Ga. 2013).

Errors and Omissions Insurance Policy Proceeds Deemed Asset of Debtor's Estate

The court quickly concluded the errors and omissions policy was an asset of the bankruptcy estate by virtue of the fact that the agent had paid for and owned the policy.

In this dispute, the bankruptcy court exercised subject matter jurisdiction over a trustee's adversary proceeding against a policyholder's insurer on the grounds that the insurer's policy and its policy's proceeds were property of the debtor's estate. Prior to filing for bankruptcy relief, a third-party escrow agent for financial services transactions was sued in two separate actions for alleged negligence in the performance of escrow services on behalf of the plaintiffs. Approximately six months after the actions were commenced, the agent filed its Chapter 7 petition and a trustee was appointed. The plaintiffs in the filed actions submitted individual proof of claims in the agent's bankruptcy case for a total amount in excess of the limits available on its errors and omissions policy. While the underlying actions were pending, the Chapter 7 trustee filed an adversary proceeding against the insurer seeking a judgment declaring that the claimants' claims were covered under the policy and directing the insurer to turn over to the trustee the aggregate limit of liability under the policy to be distributed to the agent's creditors. The court quickly concluded the errors and omissions policy was an asset of the bankruptcy estate by virtue of the fact that the agent had paid for and owned the policy. The more difficult question was whether the estate had a property interest in the policy's proceeds. The court found that because the agent was an insured under the policy, i.e. a beneficiary, and because there were claims filed against it that were potentially covered under the policy, the bankruptcy estate also had a property interest in the policy proceeds. While the court ultimately concluded that it had jurisdiction over the adversary proceeding because the estate had a property interest in both the policy and its proceeds, it chose to stay the proceeding pending resolution of the underlying actions. *EMS Fin. Serv., LLC v. Fed. Ins. Co.*, 2013 Bankr. LEXIS 139 (Bankr. E.D.N.Y. 2013).

Disgorgement Inappropriate under 'Short-Swing Profit Rule' for Sale and Purchase of Separate Securities by Corporate Insider

A shareholder brought suit against a corporate insider under Section 16(b) of the Securities Exchange Act for nine sales of Series C stock and ten purchases of Series A stock. The lower federal court dismissed the suit and the appellate court affirmed the judgment. Both courts focused on the differences between Series A and Series C stock of the issuer and relied on the use of the singular in the statute under which suit was brought. Since Series A and Series C stock were separately traded, nonconvertible, and possessed different rights, the statute was held inapplicable to the transactions for which the shareholder sought disgorgement. Despite the statute's imposition of strict liability against corporate insiders, the court found the shareholders' arguments in derogation of the plain language of the statute. "The text limits liability to profits realized from the 'purchase and sale,' or 'sale and purchase,' of any equity security of the issuer ... This indicates that, to incur Section 16(b) liability, an insider's 'purchase and sale' or 'sale and purchase' must both be directed at the same prepositional object – i.e the same equity security." *Gibbons v. Malone*, 2013 U.S. App. LEXIS 398 (2nd Cir. 2013).

Broad "Arising out of" Language Bars Entire Claim

An insured sought coverage under a D&O policy for an underlying action alleging negligence, statutory violations, breach of contract, and breach of fiduciary duty in connection with its obligations to perform reconstruction and repairs of a townhouse damaged by Hurricane Wilma. The insurer denied coverage, citing an exclusion for "Loss in connection with any Claim ... for or arising out of any damage, destruction, loss of use or deterioration of any tangible property." The insured countered that the exclusion did not apply because only part of the underlying action arose from Hurricane Wilma damages. Specifically, the underlying action sought damages for the insured's failure to properly maintain the townhouse after the work began and for statutory violations. The court held that the exclusion applied to the entire action, noting that the "arising out of" language in the exclusion required "some causal connection between the conduct and injury, but proximate cause is not required." Based on this broad definition of "arising out of," the exclusion applied since "all of the claims in the complaint flow from, grow out of, and have their origin in the property damage." The court reasoned that "had there been no property damage there would not have been a need for repairs, a need to hire qualified workers, a need to obtain permits, a need to follow building code and zoning ordinances, or a need to timely complete repairs." *Commodore Plaza Condo. Ass'n, v. QBE Ins. Corp.*, 2013 U.S. Dist. LEXIS 5195 (S.D. Fla. 2013).

...the "arising out of" language in the exclusion required "some causal connection between the conduct and injury, but proximate cause is not required."

Notice of Circumstance Sufficient for Coverage to Attach to Subsequent Lawsuit

Shortly before the expiration date and in compliance with its "claims made" E&O policy, an architectural firm timely advised its insurer of a circumstance concerning a nursing home construction project that was reasonably expected to give rise to a claim against it, as well as the particulars of the potential claim. The policy defined "Circumstance" as "an event reported during the Policy Year from which you reasonably expect a Claim may be made." The insured identified specific problem areas, as well as delays and coordination issues, along with the owner, contractor, and contractor's surety as potential claimants for millions of dollars. It noted the owner was litigious, that the contractor was looking to deflect blame, and that negotiations with the surety over honoring its performance bond were proceeding slowly. The insurer conditionally accepted the circumstance report, which it claimed was limited to seven specific design errors. The insurer requested additional information and the insured provided additional details beyond the scope of the seven specific design errors. After the policy expired, a lawsuit was filed concerning the nursing home project and the insured sought coverage. The insurer denied coverage on the basis that the suit did not relate to the earlier notice of circumstance since it asserted the insured served as a contract administrator for the project instead of the alleged design errors the insured originally reported. As a result, the insurer contended the suit was a claim first made after the policy expired. Coverage litigation ensued and the appellate court affirmed the lower court's ruling in favor of the insured because it provided the insurer with specific and detailed information about various problems concerning the nursing home project. Significantly, "nowhere in any of the notices and letters [did the insured] limit the potential claim to design errors." The court, therefore, concluded the insured's circumstance notice was sufficiently related to the subsequent suit to satisfy the terms and conditions of the policy. *Liberty Ins. Underwriters, Inc. v. Perkins Eastman Architects*, P.C., 2012 N.Y. App. Div. LEXIS 9060 (2012).

Insurer's Claim Files are Not Discoverable Due to Unambiguous Policy Language

... "the policy language setting forth coverage for advertising injury is unambiguous; neither party contends otherwise."

The insurer issued a commercial general liability policy, which provided a nutrition company with advertising liability coverage. The insured sought coverage for ten consumer class action lawsuits filed against it for false advertising related to its infant formula. The insurer asked the court to declare it had no duty to defend or indemnify the insured because the claims asserted in the lawsuits did not fall within the policy's definition of "advertising injury." During discovery, the insured asked the court to compel the insurer to provide information about the underwriting files, marketing materials, and communications with reinsurers. The coverage dispute focused on whether the claims asserted in the lawsuits fell within the policy's definition of "personal or advertising injury," which was defined as an "injury ... arising out of one or more offenses," including an "[o]ral or written publication ... that ... disparages a person's or organization's goods, products, or services." The court concluded "the policy language setting forth coverage for advertising injury is unambiguous; neither party contends otherwise." Accordingly, the extrinsic evidence at issue in the motion to compel was irrelevant and not subject to discovery. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Mead Johnson & Co.*, 2012 U.S. Dist. LEXIS 179312 (S.D. Ind. 2012).

Whether Board Member was 'Duly Elected or Appointed' is Central to Application of IvI Exclusion

This case involves an insurer's denial of coverage for a claim brought by an acquired company and its former owner for the alleged failure of the acquiring company's obligations under the purchase agreement. The coverage issue related to the "Insured" status of the plaintiff/former owner, who after the merger held a seat on the board of the acquiring company. The district court, applying New York law, denied the insurer's motion for summary judgment, finding a question of fact existed as to whether the plaintiff was a director "duly elected or appointed" as defined by the policy. Further, the court found the plain language of the policy did not override any "intent" of the exclusionary language. The insurer's denial of coverage asserted the policy's exclusionary language precluded claims "by, on behalf of, or at the direction of any of the Insureds" and the plaintiff, a former director, was an "Insured" under the policy's definition of "Director" as "all persons who were, now are, or shall be duly elected or appointed directors." In support of its position, the insurer argued that the merger resulted in the adoption of the target company's bylaws and that those bylaws were in place and complied with during the operative meeting appointing the plaintiff to the board. On the other hand, the plaintiff put forth evidence that he had been only "nominated" to the board and the requirements for election or appointment set forth in the bylaws had not been met. Based on the record before it, the court determined that a genuine issue of fact precluded the entry of judgment of the case in favor of the insurer on summary judgment. The plaintiffs also set forth an alternative pleading argument that the insured v. insured (IvI) exclusion was inapplicable in cases that do not involve collusion. The court rejected this argument and found the position overlooked the plain meaning of the language of the policy. The court reasoned that nothing in the language of the exclusion suggests there is a collusion requirement. The court found as a matter of law that a showing of collusion between the claimant and the insured was not required to apply the IvI exclusion. Although the genesis of the rationale behind the exclusion was to bar coverage for collusive suits, such as those in which a corporation sues its officers or directors in an effort to recoup the consequences of their business errors, "the exclusion's rationale does not trump its text." Accordingly, the court ruled, regardless of what the original rationale for IvI exclusions may have been, the plain language of the policy here did not set forth such a requirement. *Intelligent Digital Sys., LLC v. Beazley Ins. Co., Inc.*, 2012 U.S. Dist. LEXIS 170922 (E.D.N.Y. 2012).

SEC Filings	SEC Settlements
• The SEC filed fraud charges against Jonathan C. Gilchrist, acting president and chairman of **Mortgage Xpress, Inc.** n/k/a **The Alternative Energy Technology Center, Inc.** The SEC is seeking disgorgement, penalties and an order barring him from serving as an officer or director of a public company. • The SEC filed fraud charges against three former executives of the **Bank of the Commonwealth** and its parent company, **Commonwealth Bankshares, Inc.**, Edward J. Woodard, Jr., former CEO, president, and chairman of the board; Cynthia A. Sabol, CFO and secretary; and Stephen G. Fields, executive VP. The SEC is seeking penalties and officer and director bars.	• The SEC settled fraud charges against Francis E. Wilde, owner and principal of **Matrix Holdings LLC (Matrix)** and CEO of Riptide Worldwide, Inc.; Steven E. Woods, owner and principal of **BMW Majestic LLC (BMW)**; Mark A. Gelazela, a principal of **IDLYC Holdings Trust LLC (IDLYC LLC)** and the trustee of **IDLYC Holdings Trust (IDYLC)**; **IBalance LLC (IBalance)**; and **Shillelagh Capital Corporation (Shillelagh)** controlled by Frank Wilde. Wilde and Matrix were ordered to pay, jointly and severally, disgorgement in the amount of $12,106,810 and prejudgment interest for a total of $13,589,505. Wilde and Matrix were further ordered to pay a civil penalty in the amount of $13,589,505. Additionally, Woods, Gelazela, Haglund, BMW, IDLYC and IDLYC LLC were ordered to pay, jointly and severally, disgorgement in the amount of $6,195,908 plus prejudgment interest, for a total of $6,744,083. The order also required Woods, Gelazela, Haglund, BMW, IDLYC and IDLYC LLC to pay a civil penalty in the amount of $6,744,083. Further, Wilde and Haglund were barred from acting as officers or directors of a public company. Relief defendant, IBalance, owned by Gelazela, was ordered to pay disgorgement in the amount of $1,000,000 and prejudgment interest of $88,743. Relief defendant Shillelagh, controlled by Frank Wilde, was ordered to pay disgorgement in the amount of $323,500 and prejudgment interest in the amount of $24,475.

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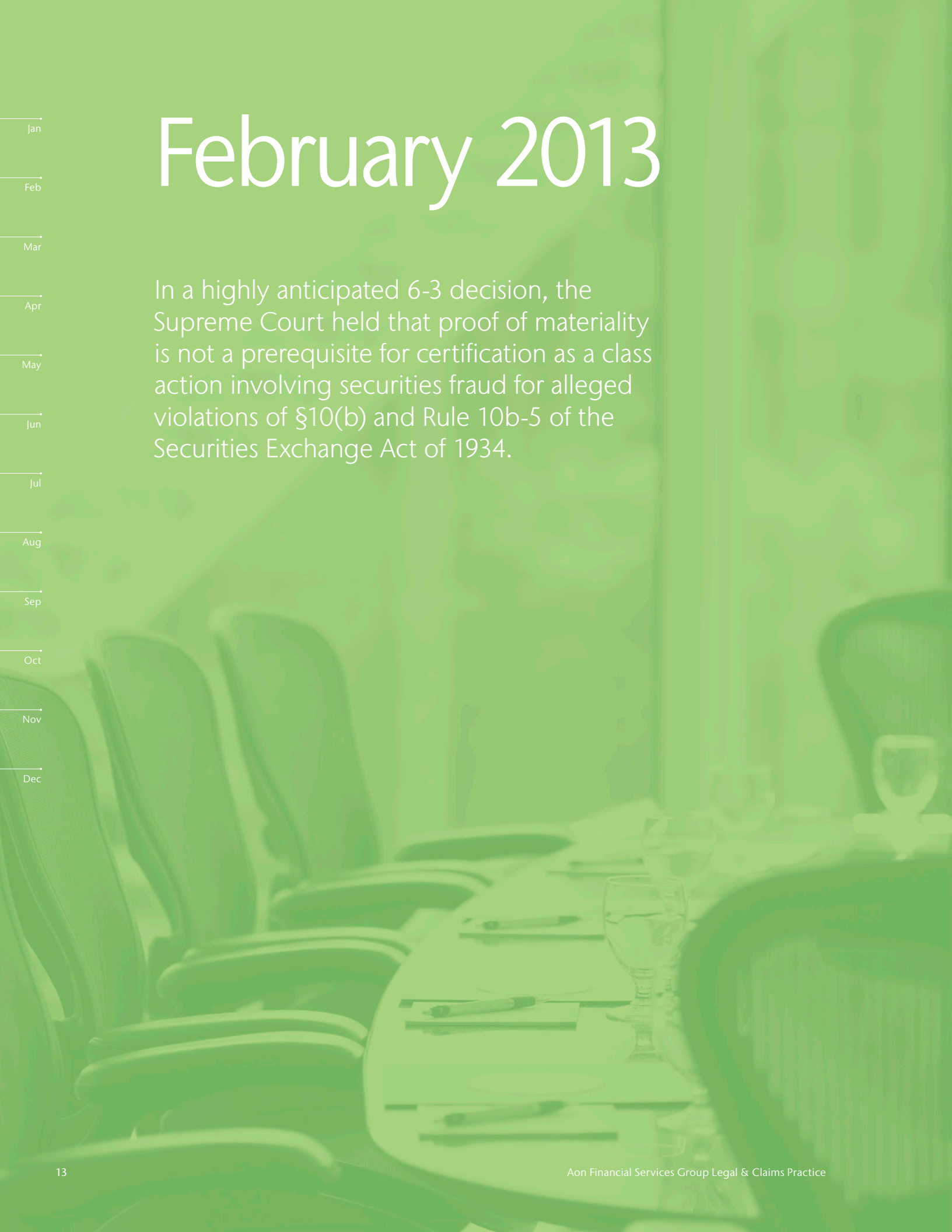

General News

U.S. Supreme Court Concludes Proof of Materiality is Not a Prerequisite to Class Certification of a Securities Fraud Suit

In a highly anticipated 6-3 decision, the Supreme Court held that proof of materiality is not a prerequisite for certification as a class action involving securities fraud for alleged violations of §10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. The central issue in *Amgen Inc., et al. v. Connecticut Retirement Plans and Trust Funds* was whether proof of materiality was required at the time of class certification to ensure that questions of law or fact common to the class would "predominate over any questions affecting only individual members" as the litigation progresses. The Court held that plaintiffs need not prove the alleged misrepresentations or omissions were "material" at the time the court addresses class certification. First, because materiality is judged under an objective standard, it can be proven through evidence common to the class; and therefore, it is a common question for class action certification purposes. Second, a failure of proof on the common question of materiality would not result in individual questions predominating. Instead, it would end the case altogether, since materiality is an essential element of a securities fraud claim. The majority held the purpose behind certification as a class action is not to adjudicate the case; but rather, to select the method best suited for adjudication of the controversy "fairly and efficiently." Amgen argued that if all of the other fraud-on-the-market predicates must be proven before class certification, materiality (another fraud-on-the-market predicate) should be treated no differently; however, the Court disagreed, stating the requirement that a putative class representative establish it executed trades "between the time the misrepresentations were made and the time the truth was revealed" relate primarily to inquiries of typicality and adequacy of representation, not whether questions of law or fact common to the class predominate. The Court also considered arguments of "policy considerations" which militate in favor of requiring precertification proof of materiality. Because class certification can exert substantial pressure on the defendant to settle rather than risk ruinous liability, it was argued that materiality may never be addressed by a court if it is not required to be evaluated at the class-certification stage. In rejecting this concern, the Court noted that materiality does not differ from other essential elements of a Rule 10b-5 claim, notably, the requirements that the statements or omissions on which the plaintiff's claims are based were false or misleading and that the alleged statements or omissions caused the plaintiff to suffer economic loss. While the outcome here was not entirely unexpected, this is a blow to defendants from a Court that in recent rulings has favored defendants in securities cases.

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Court Sends a Strong Message to Independent Directors

In a recent ruling from the bench in the *In re Puda Coal, Inc. Stockholders Litig.* case, Chancellor Strine issued a candid reminder that independent directors must satisfy their fiduciary duty of oversight, no matter where the company's assets or operations are located. The Delaware Court of Chancery refused to dismiss a claim for breach of fiduciary duty against the independent directors of Puda Coal, a Delaware corporation, whose primary assets and operations were located in China. Plaintiffs alleged the independent directors failed to detect the unauthorized sale of company's assets by its chairman. Chancellor Strine made clear that "if you're going to have a company domiciled for purposes of its relations with its investors in Delaware and the assets and operations of that company are situated in China ... in order for you to meet your obligation of good faith, you better have your physical body in China an awful lot. You better have in place a system of controls to make sure that you know that you actually own the assets. You better have the language skills to navigate the environment in which the company is operating. You better have retained accountants and lawyers who

... "you're not going to be able to sit in your home in the U.S. and do a conference call four times a year and discharge your duty of loyalty."

are fit to the task of maintaining a system of controls over a public company." Chancellor Strine made clear that independent directors cannot just absolve their failure to exercise their fiduciary duties when he stated, "Independent directors who step into these situations involving essentially the fiduciary oversight of assets in other parts of the world have a duty not to be dummy directors ... [U]nderstanding that if the assets are in Russia, if they're in Nigeria, if they're in the Middle East, if they're in China, that you're not going to be able to sit in your home in the U.S. and do a conference call four times a year and discharge your duty of loyalty. That won't cut it." In short, Chancellor Strine warned, "There's no such thing as being a dummy director in Delaware, a shill, someone who just puts themselves up and represents to the investing public that they're a monitor." Chancellor Strine emphasized that an independent director's primary purpose is to exercise his/her independence and scrutinize company management. He also mentioned that if language or cultural barriers could impede a director's ability to understand the differences in legal and ethical standards, it could be "very difficult" to fulfill one's duties. Directors need to "be careful" because they "have a duty to think." One cannot "just go on [a board] and act like this was an S&L regulated by the federal government in Iowa and you live in Iowa." Chancellor Strine's closing message concerning resignation has broader implications for independent directors. As evidence of fraud accumulated, the Puda Coal independent directors concluded it was best to resign. While this response is understandable, Chancellor Strine insinuated that such a resignation would not cure past deficiencies and given the underlying events, resignation might be a breach of fiduciary duty in and of itself.

Cases of Interest

D&O Policy's Extended Reporting Period Held to Commence after Expiration of Basic Extended Reporting Period

In this late notice dispute, the court found the supplemental extended reporting period purchased by the insured upon receiving a non-renewal notice from its D&O insurer did not begin to run until after the expiration of the policy's 60-day automatic extended reporting period. The policy was in place from November 3, 2007 to November 3, 2010. Pursuant to the policy's extended reporting provision, the insured was entitled to an automatic 60-day basic extended reporting period for no additional charge and could purchase a 12-month supplemental extended reporting period for an additional premium not to exceed 200% of the policy's expiring annual premium. With regard to the supplemental extended reporting period, the policy specifically stated that it "may be available, but only by Endorsement and for an extra premium charge. The supplemental Period starts when the Basic Extended Reporting Period ... ends." Upon being notified that its D&O policy would not be renewed by its current insurer, the insured elected to purchase the 12-month supplemental reporting period. The insured's broker negotiated the terms, the premium was paid, and an endorsement was issued. The endorsement showed the supplemental extended reporting period as running from November 3, 2010 to November 3, 2011. On December 29, 2011, a claim was made against the insured's directors and officers and submitted under the tail policy. Coverage was subsequently denied by the insurer on the basis of late notice and the insurer took the position that pursuant to the supplemental extended reporting endorsement, coverage ceased as of November 3, 2011. The insured disagreed, arguing that the supplemental extended reporting period did not expire until January 3, 2012 since the 12-month supplemental extended reporting only began to run after the 60-day automatic extension ended on January 3, 2011. In deciding the coverage dispute, the court found the policy terms on extended reporting to be inconsistent, thereby creating an ambiguity, which the court ultimately resolved in the insured's favor. In construing the policy to include the 60-day automatic basic extending reporting period in addition to the 12-month supplemental extended reporting period, for a total of 14 months in extended reporting coverage, the court concluded the claim filed by the insured was timely reported. *Anderson v. The Cincinnati Ins. Co.*, 2013 U.S. Dist. LEXIS 15366 (W.D.N.C. 2013).

U.S. Supreme Court Holds Discovery Rule Inapplicable to the SEC, Resulting in Dismissal of Claims Brought Over Five Years after Fraudulent Conduct Occurred

This important U.S. Supreme Court case centers around the meaning of "an action ... for the enforcement of any civil fine, penalty, or forfeiture ... [which] shall not be entertained unless commenced within five years from the date when the claim first accrued." The SEC alleged that two mutual fund managers allowed one of the fund's investors to engage in market timing in the fund in exchange for an investment in a separate hedge fund, but the SEC filed the action more than five years after the conduct was alleged to have taken place. The defendants argued that a claim based on fraud under the Investment Advisers Act accrues, and the five-year clock begins to run, when a defendant's allegedly fraudulent conduct occurs. The SEC argued that because the underlying violations sounded in fraud, the "discovery rule" applied, meaning that the statute of limitations did not begin to run until the SEC discovered or reasonably could have discovered the fraud. The U.S. Supreme Court held that the five-year limitations period governing SEC enforcement actions begins to run when the alleged fraud is complete. In a unanimous opinion, the Court reversed the lower court ruling which held the discovery rule applicable. The Court noted that limitations periods ordinarily begin to run upon a party's injury, but in cases of fraud where the injury itself is concealed, the discovery rule is applied to protect individuals, who are after all not required to be in a constant state of investigation.

... limitations periods ordinarily begin to run upon a party's injury, but in cases of fraud where the injury itself is concealed, the discovery rule is applied to protect individuals ...

That rationale, however, does not apply to the SEC, whose mission is to investigate (and prevent) fraud and which has statutory authority to demand detailed records, including extra-judicial subpoenas. Therefore, the Court concluded the discovery rule does not apply to the SEC and the five-year limitations period had run by the time the SEC asserted its claims, warranting dismissal of its claims. *Gabelli, et al. v. Securities and Exchange Commission,* 2013 U.S. LEXIS 1861 (2013).

Contract Exclusion in D&O Policy Only Partially Precludes Coverage for Inducement, Misrepresentation and Rescissory Damages

... the insured argued the contractual liability exclusion was limited to excluding "liability under a theory of contract," and the insurer encouraged the "but for standard.

In a methodically and factually reasoned decision, the court addressed the applicability of a D&O policy's contractual liability exclusion, holding that the exclusion barred coverage for some, but not all, of the various tort and contract claims. The underlying suit alleged the insured/franchisor and its representatives misrepresented franchise opportunities to a group of investors. The transactions with those investors ultimately did not go forward and the franchisor filed suit against the investors, who in turn counterclaimed against the franchisor. The insured sought coverage under its D&O policy for the counterclaims. The insurer paid the defense costs, but denied indemnity coverage for losses arising from the investors' counterclaims based on the policy's contractual liability exclusion, which resulted in this coverage dispute. In the coverage litigation, the insurer argued that all of the alleged wrongful acts of the franchisor were the result of liability under various contracts or unfair trade practices. The contractual liability exclusion precluded coverage for a claim against the franchisor, which is "[b]ased upon, arising from or in consequence of any actual or alleged liability of [the franchisor] under any written or oral contract or agreement, provided that this [exclusion] shall not apply to the extent [the franchisor] would have been liable in the absence of a contract or agreement." In determining the applicability of the exclusion, the court set forth a two-pronged analysis to determine whether: 1) the claim arose from liability under a contract and, if so, 2) the extent to which the insured would have been liable in the absence of its contracts with the investors. While addressing the first question, the insured argued the contractual liability exclusion was limited to excluding "liability under a theory of contract," and the insurer encouraged the "but for standard." The court fully recognized "this is a close question;" but leaned more towards the insurer's argument broadly applying the exclusion as "taking shape in a way much closer to the but for standard." The court found the scope of the exclusion included "coverage for liability under a contract, meaning liability pursuant to the existence of a contract (in other words, liability that relies upon the existence of a contract)." As to the second, the court utilized the plain language of the policy and held that claims for liability under a contract are excluded, unless the insured "would have been liable in the absence of its contracts." The court applied the two-part test to each of the six causes of action and made independent findings with respect to each. The court determined the breach of contract claim was fully excluded as there cannot be a breach without the existence of a contract and none of the damages for the breach could have existed in the absence of a breach. Similarly, the claims for violations of the Wisconsin Franchise Investment Law and the Wisconsin Theft statute were fully excluded as the liabilities for these counts relied upon the existence of misrepresentations that induced the investors to enter into the contract to purchase franchise rights. Additionally, the statutory damages for these counts are only available when there has been a purchase of a franchise or title to the investors' money by way of the contractual obligation. In contrast, the court held that the contractual liability exclusion did not exclude the portion of the settlement attributable to pre-contract damages for the intentional misrepresentation and claims of Indiana Franchise Disclosure Act and Deceptive Trade Practices Act. As a part of the reasoning, the court found that although the franchisor's liability for those counterclaims related to the contracts with the investors, the franchisor would have been liable even in the absence of the contracts for certain expenses (i.e. travel costs, research fees)

incurred by the investors during the offer/inducement period even if a deal with the investors was not consummated (as was the case here). Accordingly, because liability for the pre-contract type damages on the intentional misrepresentation and unfair trade practices counterclaims "would have existed in the absence of a contract," the contractual liability exclusion did not preclude coverage for these damages. The court also held that the exclusion would not apply to any contractual rescissory damages because those "do not arise from the contract, but instead from [the franchisor's] wrongful act of fraudulent inducement." *Cousins Submarines, Inc. v. Federal Ins. Co.*, 2013 U.S. Dist. LEXIS 17306 (E.D. Wis. 2013).

Improper Withdrawal of Defense Entitles Insured to Coverage and Precludes E&O Insurer from Contesting Coverage

This coverage dispute revolved around an E&O policy issued to a tax professional who had claims asserted against her by a client. The insured's client was audited and assessed penalties by the IRS, after which time he terminated the insured as his tax preparer. Before the client brought suit against the insured, she renewed her E&O policy, but did not notify the insurer of the client's potential claims. Following the client's initiation of litigation for malpractice, the insurer accepted the defense on behalf of the insured and hired counsel to defend her. Later, the insured provided her complete work files regarding the audit and penalties assessed, which revealed she had knowledge of a potential claim prior to the inception of the policy period. The insurer promptly withdrew its defense and the underlying case resulted in a judgment against the insured. The insured assigned her claims against the carrier to the client and the trial court concluded under the four corners rule that it was clear the policy covered negligent acts committed by the insured in her professional capacity as a tax preparer and the insurer's duty to defend had been triggered. On appeal, the trial court's ruling was upheld, concluding the insurer did not follow the proper procedures for contesting coverage without breaching its duty to defend, rendering it liable for the entire judgment entered against its insured along with interest and costs. The appellate court confirmed a breach of the duty to defend made the insurer liable to its insured for all damages which naturally flow from the breach, even if the amount exceeds the policy's limits. In rejecting the insurer's argument that no valid policy existed because the insured failed to fulfill the prior knowledge condition precedent to coverage, the appellate court held, "[The insurer] confuses a condition precedent to coverage with a condition precedent to contract formation. The prior knowledge condition precedent in [the insured's] policy provides that, in order for a claim to be covered under the policy [the insured] must not have had knowledge of the claim before the beginning of the policy period. It does not state that, if [the insured] had prior knowledge of a claim, the entire policy is void." *Kraft v. Thompson*, 2013 Wisc. App. Lexis 173 (Wis. Ct. App. 2013).

"[The insurer] confuses a condition precedent to coverage with a condition precedent to contract formation."

Damages under Liability Policy Do Not Include Restitution of Funds Wrongfully Taken

This coverage dispute arose following the filing of a class action against the insured seeking the refund of a tow release "processing fee" charged by the insured for the return of a vehicle that was towed in conjunction with an arrest. The "processing fee" was charged in addition to the actual towing fee itself. The suit sought reimbursement of all such "processing fees" charged by the insured for affected class members. The insurer then filed a declaratory action seeking to discharge its obligations to defend or indemnify its insured under the E&O policy it issued, arguing the disgorgement of funds wrongfully obtained fell outside the meaning of "damages" within the policy. Relying on two Seventh Circuit Court of Appeals decisions holding that loss within the meaning of an insurance policy does not include the restoration of ill-gotten gains, the trial court here similarly concluded that restitution of monies wrongfully obtained were not covered under the policy in effect. The court went on to explain that if the insured was able to obtain reimbursement for the funds wrongfully obtained, it would be getting away with fraud and the surrender of profits made fraudulently are not a loss within the meaning of

... the insurer was not required to defend or indemnify the insured since any damages awarded against it would constitute the return of funds unlawfully obtained through an unconstitutional ordinance.

an insurance contract. Accordingly, the insurer was not required to defend or indemnify the insured since any damages awarded against it would constitute the return of funds unlawfully obtained through an unconstitutional ordinance. *OneBeacon America Ins. Co. v. City of Granite City*, 2013 U.S. Dist. Lexis 19475 (S.D. Ill. 2013).

Suits Involving Mortgage-Backed Securities Are Not 'Securities Claims' under D&O Policy and E&O Exclusion Applies

This coverage dispute involved whether claims alleging misrepresentations and omissions in the sale of mortgage-backed securities were covered under the insured's D&O and E&O policies. The insured funded, sold, and securitized non-conforming mortgages. The court held there was no coverage under the D&O policy because the claims were not "Securities Claims," and the claims fell within the E&O exclusion. A preliminary issue addressed by the court was whether, as advocated by the insured, the duty to defend standard applied to the coverage action. The court held that the duty to defend standard did not apply since the D&O policies provided only for the advancement of claim expenses. The policies specifically stated that "[t]he Insurer does not ... assume any duty to defend under this Policy." Next, the court addressed whether the underlying claims were "Securities Claims," defined as claims "brought by any person or entity alleging, arising out of, based upon or attributable to ... the purchase or sale of or offer or solicitation of an offer to purchase or sell any securities of the Organization." The insured argued that the phrase "securities of the Organization" referred not only to the insured's own securities, but also to the mortgage-backed securities involved in the underlying claims. Specifically, the insured argued the "Mortgage-Backed Securities are also securities 'of [the insured],' both in the sense that their 'derivation, origin or source' was [the insured] and in the sense that they were 'possess[ed], connect[ed] or associate[ed]' with [the insured]." The court rejected this argument based on the language and context of the policies. First, the insured's proposed interpretation would require the phrase "securities of" to carry multiple meanings within the subsections of the definition of "Securities Claim." Second, "[the insured's] construction would result in the provision of vastly broader coverage when the insured happens to engage in the business of securitizing mortgages and would cause a traditional D&O policy for those particular companies to become a de facto E&O policy." The court then addressed whether the underlying claims were precluded by the E&O exclusion. Interestingly, the insured argued, as to the D&O carrier, that the underlying claims did not allege the insured provided professional services; however, as to the E&O carrier, the insured argued that the underlying claims did in fact arise out of its provision of professional services. The court found the underlying claims were barred by the E&O exclusion in the D&O policy because "securitization was a central element in [the insured's] business, and that the suits arising out of mortgage securitizations arise out of 'special risks inherent in' the practice of [the insured's] profession of mortgage banker." The court further reasoned that the language of the E&O policies was significantly narrower than the language of the E&O exclusion, "as it limits coverage to acts or omissions committed 'solely' in [the insured's] provision of professional 'mortgage banker/mortgage broker' services 'for others.'" *Impac Mortg. Holdings, Inc. v. Houston Cas. Co.*, 2013 U.S. Dist. LEXIS 27190 (C.D. Cal. 2013).

Contract Exclusion in Professional Liability Policy Inapplicable Where Cause of Action is Independent from Contract

The insured was in the business of brokering loans to finance its customers' purchase of boats and RVs. It sold certain loan packages to banks pursuant to agreements that required the insured to repurchase a loan if it breached any of the representations or warranties as to that loan. Several banks made demands for repayment pursuant to this provision and the insured submitted those demands to its professional liability carrier. The carrier denied the first claim on the basis that the insured was not "legally obligated to pay" the bank but rather, it was an obligation that arose out of the contractual relationship between the bank and the insured. "Damages" were defined in the policy as "any amount that you shall be legally required to pay because of judgments, arbitration awards or the like rendered against you, or for settlements negotiated by [the insurance carrier]." The court noted that no lawsuit was filed such that there was no judgment or arbitration award. Further, the court noted that the carrier did not negotiate a settlement of the matter and the insured had reimbursed the bank prior to receiving the carrier's denial letter. Thus, these amounts were not "Damages." However, the other bank claims did involve "Damages" as defined by the policy. Both matters involved arbitration proceedings and the settlements were made after the carrier declined coverage. The court also found that the alleged misrepresentations could be "Wrongful Acts" as defined by the policy even though a contract was involved. To interpret the "Wrongful Act" definition narrowly and assert that anything arising out of a contract was outside the scope of "Wrongful Acts" would render the contract exclusion superfluous. The contract exclusion provided that there was no coverage for claims "arising out of liability you assume under any contract ... however, this exclusion does not apply to liability you would have in the absence of such contract or agreement." In this case, using the broad "arising out of" language, because of the agreements involved, the court found the exclusion would preclude coverage unless the insured would be liable in the absence of the contract. With respect to one of the remaining claims, the court found that the exception applied such that coverage was available. That matter also included a cause of action for negligent misrepresentation, which under Florida law was not barred by the existence of a contract. Thus, the insured faced liability in the absence of the contract and coverage was available for the negligent misrepresentation claim. *Marinemax, Inc. v. National Union Ins. Co. of Pittsburgh*, 2013 U.S. Dist. LEXIS 14641 (M.D. Fla. 2013).

... the exclusion would preclude coverage unless the insured would be liable in the absence of the contract.

SEC Filings	SEC Settlements
• There were no filings of any significance this month.	• The SEC settled insider trading charges against four executives of **Steel Technologies, Inc.** Patrick M. Carroll, senior VP, was ordered to pay disgorgement of $34,279, prejudgment interest of $10,412, and a penalty of $34,279. William T. Carroll, VP of Sales, was ordered to pay disgorgement of $54,163, prejudgment interest of $16,452, and a penalty of $54,163. David Mark Calcutt, VP of Sales, was ordered to pay disgorgement of $150,297, prejudgment interest of $45,652, and a penalty of $150,297. David Stitt, VP of Sales, was ordered to pay disgorgement of $22,796, prejudgment interest of $6,924, and a penalty of $42,796. • The U.S. District Court for the District of Columbia entered judgment on fraud charges against three former officers of **Gibraltar Asset Management Group, LLC.** Benjamin C. Dalley, former VP of Operations, was ordered to pay disgorgement of $72,500, and a penalty of $40,000. Randolph M. Taylor, former VP for Organizational Development, was ordered to pay disgorgement and prejudgment interest of $584,148. William B. Mitchell, former EVP of Strategic Planning, was ordered to pay disgorgement and prejudgment interest of $164,131. • The SEC settled insider trading charges against Steven Harrold, former VP at **Coca-Cola Enterprises,** Inc. Harrold was ordered to pay disgorgement of $86,850, prejudgment interest of $8,954, and a penalty of $86,850. Additionally, Harrold was barred from serving as an officer or director of a public company. • The SEC settled fraud and stock option backdating charges against two former executives of **Mercury Interactive, LLC**. Amnon Landan, former chairman and CEO, was ordered to pay disgorgement and prejudgment interest of $1,252,822, a penalty of $1,000,000, and was barred from serving as an officer or director of a public company for five years. Douglas Smith, former CFO, was ordered to pay disgorgement of $451,200 and a penalty of $100,000.

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March 2013

Chancellor Strine argued the increase in suits, and in the resulting settlements involving only what he characterized as rather meaningless disclosures, could be at least partially blamed on a rise in multi-state lawsuits.

General News

Private Equity Funded Litigation Gains Steam in the U.S.

Impressive returns by commercial litigation funding firms abroad have spawned the entry of similar litigation-for-profit ventures in the states. Juridica and Buford Capital, both listed on the London AIM exchange, posted $38 million in profits on $256 million under investment and a 61 percent net return in 2012, respectively. With this in mind, and in light of the lack of regulation or barriers to entry in the U.S. market, numerous such entities are entering the fold. Fulbrook Capital Management and Gerchen Keller Capital recently opened their doors, with the latter envisioning a business model emphasizing investments in cases on behalf of the defense, purportedly allowing defendants and defense firms to offset risk. While the private financing of litigation on behalf of plaintiffs is nothing new, its presence on a larger scale and the ethical quandaries presented by the potential conflicts of interest have caused a flurry of recent media attention. Articles in the Wall Street Journal, Economist, Law360, and a host of other internet outlets reported that litigation funding in Canada and Australia has become a significant part of the class action landscape, with such arrangements approved by the courts. Supportive arguments note that the requirement to produce a return on capital serves as a disciplining mechanism, i.e. to only become involved in meritorious cases. On the other hand, the entanglement of interests between litigants and private equity firms invested in the outcome of ongoing litigation is likely to prolong resolution, further burden the judiciary, and cause the filing of frivolous suits. Whether you view the private funding of litigation to level the playing field for smaller litigants taking on larger adversaries, or a perversion of the concept of justice, until regulation of such matters is undertaken, it appears here to stay.

...the entanglement of interests between litigants and private equity firms invested in the outcome of ongoing litigation is likely to prolong resolution, further burden the judiciary, and cause the filing of frivolous suits.

Benefits Obtained through M&A Litigation Questioned by Delaware Court of Chancery

Chancellor Strine recently rejected a proposed settlement agreement in a case challenging the sale of a corporation, holding that the parties failed to show the additional disclosures to the proxy statement would have been meaningful or interesting in any real way to someone voting on the transaction. Chancellor Strine was quoted as saying that with respect to merger and acquisition (M&A) litigation, "[t]he catfish can't get much lower." Speaking at a recent M&A industry conference, Chancellor Strine argued the increase in suits, and in the resulting settlements involving only what he characterized as rather meaningless disclosures, could be at least partially blamed on a rise in multi-state lawsuits. The reasoning is that if a corporation has to defend itself just in Delaware, it may actually defend itself, while if it has to defend itself in several states, a settlement may be more appealing. Consistent with Chancellor Strine, Vice Chancellor Parsons argued in a law review article titled *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, that Delaware cases belong in Delaware courts, noting that "[b]y forcing director-defendants to combat essentially the same adversary with many heads ... multi-jurisdictional shareholder litigation imposes additional burdens on, and amplifies various risks for all parties involved." As an example, two Delaware judges have found that "don't ask, don't waive" provisions present in many confidentiality agreements that interested buyers sign with target boards are troubling; while a county judge in Washington overseeing a shareholder challenge to the sale of a corporation found that the same provision was not a problem. However, some commentators have opined that Delaware's tough stance on M&A litigation may have the reverse effect of keeping Delaware-related cases in-state, and may encourage plaintiffs to file in "friendlier" jurisdictions.

If the carrier's lawsuit implicated the exercise of an FDIC receivership power and the action to be taken would affect the FDIC, then FIRREA would preclude the lawsuit.

Cases of Interest

FIRREA Bars Carrier's Suit Seeking Declaration of No Coverage

The insurer provided a management and professional liability insurance policy to a bank that went into receivership. Shortly before the expiration of the extended reporting period, the Federal Deposit Insurance Corporation (FDIC), as receiver, made a claim against the directors and officers of the bank for violation of their duties of loyalty and care in connection with certain loan transactions and an allegedly improper dividend that purportedly caused the bank to fail. However, the carrier did not receive the notice prior to expiration of the extended reporting period. The carrier sought a declaration from the court that: 1) the insured v. insured (IvI) exclusion applied; 2) late notice barred the claim; and 3) the restitution carve-out from the loss definition precluded coverage for some of the amounts sought. The individual directors and officers asserted the carrier's lawsuit was precluded by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which provides that "no court may take any action ... to restrain or affect the exercise of powers or functions of the [FDIC] as a conservator or a receiver." If the carrier's lawsuit implicated the exercise of an FDIC receivership power and the action to be taken would affect the FDIC, then FIRREA would preclude the lawsuit. The court considered other cases that held it is sufficient to invoke the statutory bar when the FDIC may assert its powers in the future. Further, the exceptions to the jurisdictional bar are "extremely limited." The court then noted "[t]he FDIC Claim seeks to recover sums owed to the bank because of the D&Os' alleged wrongful conduct; if the FDIC succeeds, the D&O Coverage would help satisfy any judgment for the bank." Thus, the court found that issuing a declaratory judgment on the carrier's claims would affect the FDIC's ability to collect money from the bank, and noted that the carrier could pursue its claims through the FIRREA administrative process. *OneBeacon Midwest Ins. Co. v. Federal Deposit Ins. Corp. as Receiver for Habersham Bank, et al.*, 2013 U.S. Dist. LEXIS 44237 (N.D. Ga. 2013).

Rescission Upheld for Misrepresentations on E&O Policy Application

The Sixth Circuit affirmed a decision upholding rescission of an accountant's professional liability policy. The coverage case involved three professional liability policies issued to an Ohio accountant (who was serving time for wire fraud), and the two companies in which he had an ownership interest. The lower court found that the insurer was entitled to rescind the policies on the basis that the insured lied on his policy application with the intent of obtaining the malpractice insurance and that the lies were "material" to the insurer's evaluation of the risk. In upholding the rescission, the Sixth Circuit cited Ohio's well-developed precedent on the elements required to succeed on its claim for rescission: "1) that there were actual or implied representations of material matters of fact; 2) that such representations were false; 3) that such representations were made by one party to the other with knowledge of their falsity; 4) that they were made with intent to mislead the insurer to rely thereon; and 5) that the insurer relied on such representations with a right to rely thereon." In this case, the court found the rescission elements were met and only expounded on the "intent" and "material" elements. On the intent prong, the court found the unwavering findings of the lower court convincing as to falsity and fraudulent intent of the insured in answering application questions relating to investment activities and professional disciplinary actions. The lower court concluded "[n]o rational fact-finder could conclude otherwise than that [he] lied with the intent to deceive the plaintiff [insurer] and induce it to issue the policies." The court found that the applicant gave false answers to at least three questions, not once, but several times, thus precluding any finding but intent to deceive. As to the "materiality" component, the appeals court held that the lower court correctly relied upon the undisputed testimony of the insurer's underwriting representative. The seasoned underwriter testified that had she known the falsity

of the misrepresentations, she would not have issued or renewed the policies. The insured failed to refute the underwriter's testimony and the court held that the questions (and the false answers) were, by their very nature and circumstance, material. The insureds challenged the insurer's position by arguing they were prejudiced because the insurer did not initially raise rescission as one of its coverage defenses. The Sixth Circuit rejected that argument and found that rescission was raised early enough in the process so as to avoid undue prejudice to the insureds. It was insignificant that the insurer's amendment to the complaint to add the rescission count was filed a full year after the deadline for amending pleadings; but more importantly, the filing was "only two years into a case that lasted a decade." *Chicago Ins. Co. v. CWN Group, Inc.*, 2013 U.S. App. LEXIS 2780 (6th Cir. 2013).

Judge Denies Motion to Dismiss Rescission Action

In this coverage dispute, a federal trial court rejected an insurer's request for rescission of a professional liability policy and permitted limited discovery with respect to the insurer's underwriting guidelines and decision-making process in issuing the policy. The crux of the dispute involved the distinction between severability of exclusions and severability of the application as it pertained to individuals covered under the policy. Shortly after the policy was issued, the Securities and Exchange Commission (SEC) filed an enforcement action against the principals of the insured in connection with an alleged scheme involving the sale of fictitious securities. The insureds sought coverage for the SEC action, along with complaints filed by clients who lost money in the alleged scheme. The insurer denied coverage for the claims and sought to rescind the policy based on its belief that the insureds made material misrepresentations in the application process. Individuals who were not involved in the procurement of the policy but whose coverage would be lost if the insurer was successful in its request for rescission, argued that the severability of exclusions barred rescission. However, the court disagreed, finding that the policy's "Innocent Insured" provision did not equate to severability of the application such that coverage for the individual insureds would be preserved. The provision stated, "If coverage under this policy would be excluded as a result of any criminal, dishonest, illegal, fraudulent or malicious acts of any of you, we agree that the insurance that would otherwise be afforded under this Policy will continue to apply to any of you who did not personally commit, have knowledge of, or participate in such criminal, dishonest, illegal, fraudulent or malicious acts or in the concealment thereof." In denying the insured's motion, the court reasoned that the "Innocent Insured" provision only comes into play in a situation where coverage is being denied based on a policy's "bad acts" exclusion. Because an insurer seeking rescission has the burden of proving there was a material misrepresentation in the application process (something an insurer may establish as a matter of law by submitting "evidence of its underwriting practices with respect to similar applicants"), and because no such evidence had been submitted in the case, the judge held that summary judgment in favor of the insurer was premature and limited discovery regarding the insurer's underwriting guidelines and process was necessary before a summary judgment ruling would be appropriate. *Continental Casualty Co. v. Marshall Granger & Co. LLP, et al.*, 2013 U.S. Dist. LEXIS 13541 (S.D.N.Y. 2012).

Additional Claims Included in Amended Complaint Covered under Related Wrongful Act Provision

In this coverage dispute, the court rejected the insurer's attempts to avoid defending False Claims Act allegations brought against its insured, finding the claims were sufficiently related to a wrongful termination claim brought within the policy period. The insured, a biopharmaceutical company, purchased a multi-coverage management liability policy that provided coverage for both employment practices and directors' and officers' liability. Prior to the expiration of the policy, the insured's former CEO asserted a claim for wrongful termination,

alleging retaliation for reporting financial irregularities at the company. A suit was filed by the former CEO against the insured and the insurer initially agreed to provide a defense. A few months after the policy expired, the former CEO amended his original complaint to include a qui tam action on behalf of the United States Government asserting the insured had violated the False Claims Act. The insurer then argued that the qui tam claims were not covered. The question for the court was whether the allegations in the amended complaint related back to the wrongful termination claim such that the qui tam action would be covered under the policy. The policy provided, "All Claims based upon or arising out of the same Wrongful Act or any Related Wrongful Acts, or one or more series of any similar, repeated or continuous Wrongful Acts or Related Wrongful Acts, shall be considered a single Claim ..." The coverage defined "Related Wrongful Act(s)" as "Wrongful Acts which are logically or causally connected by reason of any common fact, circumstance, situation, transaction, casualty, event, or decision." The court rejected the insurer's argument that the qui tam and retaliation claims were separate and distinct, holding that the qui tam claim and the anti-retaliation claim were based on related wrongful acts as defined in the policy. In so ruling, the court held that the "... policy's test for a related wrongful act is not whether there are differences between the acts, but whether there is 'any common fact, situation, event or decision' that 'logically ... connects' the acts." *Carolina Cas. Ins. Co. v. Omeros Corp.*, 2013 U.S. Dist. LEXIS 38811 (W.D. Wash. 2013).

... "[the] policy's test for a related wrongful act is not whether there are differences between the acts, but whether there is 'any common fact, situation, event or decision' that 'logically ... connects' the acts."

Insured v. Insured Exclusion and Defective Notice of Circumstance Bar Coverage

This coverage dispute focused on whether former officers and directors of a bank in receivership were entitled to coverage under a D&O policy for claims asserted against them by the FDIC. During the relevant policy period, the FDIC issued a cease and desist order, which the insureds forwarded to their insurer, informing it that claims against the bank and/or its current or former directors, officers, or employees may result from actions being taken by the FDIC. Within the same policy period, the insureds provided the insurer with an additional notice which included a list of potential allegations that might be made against the insureds, and identified twelve loans from which alleged losses could potentially arise. After the policy expired, the FDIC sent a letter accompanied by subpoenas notifying the insureds that the FDIC had been authorized to bring a civil action for negligence. The insurer denied coverage entirely, asserting: 1) a claim had not been made within the policy period; 2) the insureds had not provided proper notice within the policy period for a claim made outside the coverage period to be covered; and 3) the Ivl exclusion barred coverage for any claims brought by the FDIC. The court sided with the insurer, holding that there was no coverage under the D&O policy. First, the court concluded the letters sent within the policy period by the insureds were defective in that they failed to satisfy the requirements for notifying the insurer of a potential claim, commonly referred to as a "notice of circumstance." The court compared the notice provisions in the policy against both letters sent by the insureds and found that they "did not identify any actual or alleged error, misstatement, misleading statement, act or omission or neglect or breach of duty, and did not provide all five categories of requested information" required by the terms of the policy. Specifically, the court found that, "[d]espite their attempt to provide detailed information, [the insureds'] letter did little more than document the bank's declining financial strength, poor lending practices, and mismanagement." Next, the court reasoned that the Ivl exclusion, which barred coverage for claims brought "by, or on behalf of, or at the behest of, any other Insured Person ... or any successor, trustee, assignee or receiver of the Company" precluded coverage for the claims asserted by the FDIC. In so ruling, the court distinguished cases holding the Ivl exclusion inapplicable to claims brought by the FDIC, noting that none of those cases "involved policy language expressly providing that the exclusion applied to successors, receivers, assignees and trustees." Finally, the court rejected the insureds' argument that the insurer was required to advance defense costs pursuant to a carve-out. The court reasoned that for the carve-out to apply, the claim must be "otherwise

insured and not excluded by the Policy." Here, the claims were not otherwise insured because they were not made within the policy period and the insureds did not satisfy the policy's notice requirement. *Davis v. Bancinsure*, 2013 U.S. Dist. LEXIS 46249 (N.D. Ga. 2013).

Subpoenas Constitute "Claims" under Not-for-Profit D&O Policy

An insured university received multiple subpoenas in connection with state and federal investigations concerning allegations that one of its assistant basketball coaches, in his official capacity, had sexually abused two former participants in the insured's basketball program over a period of years. The insured tendered the subpoenas as "Claims" under a not-for-profit individual and organization insurance policy. Coverage litigation ensued after the insurer denied coverage, arguing the subpoenas were not "Claims," defined under the policy as: "1) A written demand for monetary, non-monetary, or injunctive relief; or 2) A civil, criminal, administrative, regulatory, or arbitration proceeding for monetary or non-monetary relief which is commenced by: i) service of a complaint or similar pleadings; or ii) return of an indictment, information or similar document in the case of criminal proceeding; or iii) receipt or filing of a notice of charges ...." The court concluded the grand jury's investigations and the subpoenas met the first prong of the claim definition, constituting a "written demand ... for non-monetary relief," and the investigations also satisfied subparagraph 2 of the claim definition, as "criminal proceedings for monetary or non-monetary relief which [are] commenced by: ... ii) return of an indictment, information or similar document ...." The court further articulated that the subpoenas were a "demand" because under New York and federal law, any failure to comply with a grand jury subpoena is punishable by fine or imprisonment as contempt of court. In addition, "[t]he relief sought by a subpoena is the production of documents or testimony," which the court deemed non-monetary relief. The court highlighted that when a prosecuting attorney serves a subpoena, a proceeding "is instituted in the grand jury, just as in an analogous situation a civil action is commenced by the service of a summons." The court summarily rebuffed the insurer's contention that for a "Claim" to arise, an insured must prove that it was a "named target" of an investigation. The court noted that a duty to defend attaches when any allegation is asserted that can potentially bring the claim within the policy's insuring agreement. Although the subpoenas were mainly directed at the assistant coach, the insured's potential liability was dependent on his culpability. The allegations against the assistant coach were closely related to the insured's basketball program and the assistant coach's actions. Accordingly, although the insured might not have been the target of the grand jury investigation at the time the subpoenas were issued, that fact would not prevent prosecutors from bringing charges against the insured from information gleaned through the subpoenas. The court also rejected the insurer's contention that the subpoenas did not reference a "wrongful act" by the insured. The subpoena sought information to determine if the insured was involved "in an institutional cover-up of [the assistant coach's] alleged misdeeds ... and thus engaged in a breach of duty." Consequently, the court concluded the subpoena sought information which met the policy's definition of wrongful act concerning "any breach of duty, neglect, error, misstatement, misleading statement, omission or act by or on behalf of the organization." *Syracuse Univ. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. 2012EF 63 (Sup. Ct. Onondaga County 2013).

... the subpoenas were a "demand" because under New York and federal law, any failure to comply with a grand jury subpoena is punishable by fine or imprisonment as contempt of court.

SEC Filings	SEC Settlements
• The SEC filed fraud charges against John P. Rohner, founder, president, CEO, treasurer, and director of **Inteligentry, Ltd.**, **PlasmERG, Inc.** and **PTP Licensing, Ltd.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Rohner from serving as an officer or director of a public company.	• The SEC settled insider trading charges against Michael Dale Lackey, former VP and general manager of **International Paper Company**. Lackey was ordered to pay disgorgement of $56,534, prejudgment interest of $2,942, a penalty of $56,534, and was barred from serving as an officer or director of a public company for five years.
• The SEC filed fraud charges against **Falcon Ridge Development, Inc.** and Fred M. Montano, its president and CEO. The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Montano from serving as an officer or director of a public company.	• The SEC settled stock options backdating fraud charges against Susan Skaer, former GC and secretary of **Mercury Interactive Corporation**. Skaer was ordered to pay disgorgement of $628,037 and a penalty of $225,000.
• The SEC filed insider trading charges against David Riley, former CIO for **Foundry Networks, Inc.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Riley from serving as an officer or director of a public company.	• The SEC settled insider trading charges against **Sigma Capital Management (Sigma)**. Sigma was ordered to pay disgorgement of $6,425,000, prejudgment interest of $1,094,162, and a penalty of $6,425,000.
	• The SEC settled insider trading charges against Juan Carlos Bertini, a VP of finance at **Del Monte Foods Company**. Bertini was ordered to pay disgorgement of $16,035, prejudgment interest of $961, a penalty of $32,070, and was barred from serving as an officer or director of a public company for five years.
	• Final judgments on fraud charges were entered by the U.S. District Court, Middle District of Tennessee against **J.C. Reed & Company (JC Parent)**, and Barron A. Mathis, a director of JC Parent. JC Parent was ordered to pay disgorgement of $11,000,000 and prejudgment interest of $3,910,004. Mathis was ordered to pay disgorgement of $11,000,000 and prejudgment interest of $4,944,175.

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"Settlement size increases as the cases move through the early pleading stage to the discovery stage. The mean settlement for cases that settle in the discovery stage is over $60 million, while the mean settlement of cases that settle in the early pleading stages is less than $20 million."

General News

Analyzing the Timing and Size of Securities Class Action Settlements

Authors Michael Klausner, Jason Hogland and Matthew Goforth of Stanford Law recently updated earlier research published in a 2012 PLUS Journal in a new article titled *When Are Securities Class Actions Dismissed, When Do They Settle and For How Much? An Update*. The authors examined 652 securities class action lawsuits from 2006 to 2010 in order to gauge when and how such cases are being resolved. "Of the 652 cases, 119 (18%) are ongoing, 257 (40%) have settled, 206 (32%) have been dismissed with prejudice, and 74 (11%) have been voluntarily dropped." The mean settlement amount is $36 million, with the median being $9 million. It was found that over half of the lawsuits were resolved well before the discovery phase began, or before a second amended complaint was filed. 25% percent of the cases were resolved by way of a motion to dismiss being granted with prejudice, an additional 9% of cases were voluntarily dismissed before a motion to dismiss was ruled upon, and another 4% were dropped after a motion to dismiss without prejudice was granted. Certain factors, such as a parallel Securities and Exchange Commission (SEC) enforcement action, or earnings restatements, lessened the likelihood of a case being dismissed. As to the timing of settlements, 43% occurred during the pleading stage, with 57% taking place during the discovery phase of litigation. The authors also found that settlement size correlated with the timing of when an agreement was reached to resolve the matter. "Settlement size increases as the cases move through the early pleading stage to the discovery stage. The mean settlement for cases that settle in the discovery stage is over $60 million, while the mean settlement of cases that settle in the early pleading stages is less than $20 million." Finally, the authors found their findings consistent with a prior study covering the 2000-2004 time period, noting "the forces shaping the patterns of dismissal and settlement over the past decade have remained stable."

"The mean settlement for cases that settle in the discovery stage is over $60 million, while the mean settlement of cases that settle in the early pleading stages is less than $20 million."

The Long-Term Value of Insulating Boards

A recent article posted by Lucian A. Bebchuk, Professor of Law, Economics and Finance at Harvard Law School, examined the issue of insulating corporate boards from activist investors. The post is based on a study, *The Myth that Insulating Boards Serves Long-Term Value* (forthcoming, Columbia Law Review, October 2013). The author argues this study comprehensively analyzes - and debunks - the view that insulating corporate boards serves long-term value. Advocates for board insulation argue that shareholder interventions, and the fear of such interventions, lead companies to take actions that are costly in the long term, and that insulating boards from such pressure serves the long-term interests of companies and their shareholders. The author counters that "shareholder activism, and the fear of shareholder intervention, will produce not only long-term costs but also some significant countervailing long-term benefits." A question remains how often activists seek actions that are not value-maximizing in the long term and, furthermore, "whether the expected costs of such situations exceed the expected benefits from activists' clear interest in seeking actions that are positive for both the short term and the long term." For example, the accountability and discipline produced by activists provide incentives to avoid shirking, empire building, and other departures from shareholder interests that are costly for both the short term and long term. In addition, the negative long-term costs of board insulation might exceed its long-term benefits. According to the article, "the overwhelming opposition to insulation-increasing arrangements reflected in the voting decisions of institutional investors ... indicates that these investors do not subscribe to the view that such arrangements serve long-term value." Further, arrangements that insulate boards from shareholders and shareholder pressure have been consistently associated with lower firm value, as well as with worse operating performance. Thus, the author concludes policymakers and institutional investors should reject arguments for board insulation in the name of long-term value.

Cases of Interest

FTC Investigation Not a Claim under Private D&O Policy

This coverage dispute involved whether a claim was made prior to the policy period when the Federal Trade Commission (FTC) began an investigation into whether the insured's acquisition of a hospital violated antitrust laws. Prior to the inception of the relevant policy, the FTC issued a resolution authorizing the use of compulsory process in connection with its investigation of the insured. The insured and the FTC also executed a Hold Separate Agreement, placing limited constraints on its operations of the acquired hospital. Finally, the FTC issued subpoenas to the employees and entities, as well as civil investigative demands to the entities. After the relevant policy incepted, the FTC filed administrative and civil actions alleging the insured's acquisition violated antitrust laws. The insured submitted these actions to its carrier, which then denied coverage arguing that a claim was first made prior to the policy period when the FTC issued the resolution authorizing the commencement of a formal investigation, or alternatively, when the Hold Separate Agreement was executed. On appeal, the trial court's decision in favor of the insurer was reversed. The appellate court held the claim was first made when the FTC commenced the administrative and civil actions. It first reasoned that none of the actions taken by the FTC prior to inception of the relevant policy period alleged wrongful acts by the insured. Under the policy, a wrongful act included "any actual or alleged" antitrust violation. The court focused on the word "alleged" and found the FTC did not "assert to be true" or "declare" that antitrust violations had occurred or would occur if the insured acquired the hospital. Rather, the FTC sought to determine "whether" such violations had occurred or would occur. The FTC "simply discussed in hypothetical terms the possibility [of] an antitrust violation." The court also reasoned that none of the FTC actions occurring pre-policy were "written demands" or commenced "proceedings" seeking "monetary, non-monetary or injunctive relief" as required by the definition of claim. *Emplr's. Fire Ins. Co. v. Promedica Health Sys.*, 2013 U.S. App. LEXIS 8943 (6th Cir. 2013).

... none of the FTC actions occurring pre-policy were "written demands" or commenced "proceedings" seeking "monetary, non-monetary or injunctive relief" ...

Insured v. Insured Exclusion Inapplicable to Trustee's Claim Brought in Right of Bankruptcy Estate

This coverage dispute arose out of an insurer's denial of coverage for claims brought by the bankruptcy trustee against the bankrupt insured and its board members. In denying coverage, the insurer relied on the insured versus insured (IvI) exclusion, specifically the language excluding coverage for claims "by, on behalf of, or in the right of the insured entity in any capacity." Applying Louisiana law, the court found the insurer did not meet its burden of establishing, as a matter of law, that the IvI exclusion barred coverage for claims brought by the trustee. The insurer appealed; however, the bankruptcy court's reasoning was upheld, finding that the exclusion only applied to claims in the present case if the trustee could be deemed the "Insured Entity" and that a "duly appointed bankruptcy trustee is not the insured debtor for purposes of the insured versus the insured exclusion." In this case, once the debtor filed for relief under Chapter 7, all of its claims against its former officers and directors flowed into the bankruptcy estate. The court pointed out the bankruptcy estate and Chapter 7 trustee appointed to administer the estate were separate and distinct entities from the pre-petition debtor. "Because a Chapter 11 debtor-in-possession is different than a Chapter 11 trustee that is appointed by the court, claims by a debtor-in-possession, or its assignee, against a director or officer might possibly be precluded by an [IvI exclusion] while the same action against the same director or officer brought by a Chapter 11 trustee in the same case might not be excluded by [the] clause." The court reasoned "a pre-petition debtor is the same entity as a debtor-in-possession" while a "pre-petition debtor is not the same entity as the Chapter 11 trustee." Thus, the court distinguished the instant case from cases where claims were not brought by a bankruptcy trustee, but instead, were brought by a debtor-in-possession, or a plan committee/trust. It was a critical distinction to the court that in this case, the trustee was not asserting these claims in the right of the insured entity, but in the right of the bankruptcy estate. *Admiral Ins. Co. v. Wilson*, 2013 U.S. Dist. LEXIS 47009 (W.D. La. 2013).

'Arising out of' Language Given Broad Interpretation Even in Exclusionary Provision

This coverage dispute involved a bank's D&O insurer's denial of coverage based on the exclusionary language "for Loss on account of any Claim...based upon, arising from, or in consequence of the performing or failure to perform ... Lending Services." The underlying case which gave rise to the insurance claim concerned the bank's loan to a customer for the purchase of a restaurant. The customer executed a lease for an existing restaurant and the bank filed multiple deeds on the property securing its interest. Subsequently, the loan went into default and the property owner sought new tenants; however, the bank refused to release the deeds and the owner was unable to secure new tenants absent a clear title. This led to the property owner's lawsuit against the bank, along with its directors and officers, claiming the liens were fraudulent. The D&O insurer refused to defend the bank, relying on the "lending services" exclusion. The bank challenged the insurer's denial, arguing damages to the property owner were caused by intentional failure to remove liens, as opposed to the act of recording them. The court disagreed, finding the bank's argument to completely ignore the express language of the exclusion and failed to acknowledge the underlying complaint's allegations of damages resulting from both the bank's fraudulent recording of the liens and its subsequent refusal to remove them. The court found the allegations established that both actions arose from, or were in consequence of, the bank's failure to properly perform lending services. The court interpreted "arising out of" to mean "very broad, general and comprehensive terms, ordinarily understood to mean 'originating from,' 'having its origin in,' 'growing out of' or 'flowing from.'" Since the bank's placement of liens on the property and refusal to remove them occurred in the course of, and as a direct result of, the bank's lending services, the underlying case was held within the lending services exclusion and the insurer's denial of coverage proper. *Western Heritage Bank v. Fed. Ins. Co.*, 2013 U.S. Dist. LEXIS (D. N.M. 2013).

The court interpreted "arising out of" to mean "very broad, general and comprehensive terms, ordinarily understood to mean 'originating from,' 'having its origin in,' 'growing out of' or 'flowing from.'"

Single Lawsuit Consists of Multiple Claims

The dispute in this case focused on the meaning of the term "Interrelated Wrongful Act" in an E&O insurance policy. The policy had a $1 million per claim limit of liability, with a $2 million aggregate limit for multiple claims. Four plaintiffs filed suit against their former financial planner, alleging the advisor breached her fiduciary duties to them by recommending unsuitable investments, misrepresenting the nature of the investments, and churning their accounts. A Minnesota federal judge held the plaintiffs' claims were not "Interrelated Wrongful Acts" as defined by the financial planner's E&O policy, therefore the full $2 million aggregate limit was available for the multiple lawsuits. The insurer argued that since the plaintiffs brought their claims in a single civil proceeding, the matter constituted a single claim under the policy. The court disagreed that a lawsuit and an insurance claim are one and the same. The court found "the concept of a 'claim' within the meaning of insurance policies is textual rather than procedural." The policy defined "Interrelated Wrongful Acts" as those that are "logically or causally connected by reason of any common fact." Thus, in order for claims to be related, they must have a shared fact or circumstance that logically or causally ties them to one another. Having similarities is simply not enough. Accordingly, the court found the plaintiffs' claims exist "in parallel ... not in connection to each other." In support if its finding that the plaintiffs stated multiple claims, the court pointed to the fact that the financial advisor met each of the plaintiffs separately at different times, had a separate relationship with each, and that while some of the investments were similar, the plaintiffs' portfolios were quite varied. An appeal by the insurer is pending. *Kilcher, et al. v. Continental Casualty Co.*, 2013 U.S. Dist. LEXIS 46658 (D. Minn. 2013).

Unless Exclusion Only Susceptible to One Reasonable Interpretation, Dismissal of Coverage Action Improper

This dispute arose after an insured's request for coverage under an E&O policy was denied. A class action lawsuit had been filed against the insured alleging false representations were made regarding UPS delivery fees and order-processing charges for event tickets. The insurer relied on an exclusionary provision, which specified the policy in question did not apply to any claim "based on or arising out of ... any dispute involving fees, expenses or costs paid to or charged by the Insured" in declining to defend or indemnify the insured in the underlying litigation. The insured brought this case to challenge the denial; however, the trial court agreed with the insurer and dismissed the suit. On appeal, the case was reinstated and dismissal reversed. The federal appellate court held the trial court's dismissal improper by failing to subject the exclusion relied on to the "closest possible scrutiny. When narrowly construed ... Exclusion E is reasonably susceptible to at least two meanings ... and is thus, ambiguous." The court found the exclusion could refer to disputes regarding the monetary amount paid to or charged by the insured for uncontested services, or to any dispute regarding a fee or charge for professional services, including a dispute regarding the relationship between services provided and the fees charged. As such, the court held the insurer failed to satisfy its burden of showing that its interpretation of Exclusion E was the only reasonable one, and vacated the trial court's dismissal, thereby reinstating the breach of contract and bad faith claims against the insurer for its denial to defend or indemnify for claims in the underlying case. *Ticketmaster, LLC v. Illinois Union Ins. Co.*, 2013 U.S. App. LEXIS 8554 (9th Cir. 2013).

...the court held the insurer failed to satisfy its burden of showing that its interpretation of Exclusion E was the only reasonable one, and vacated the trial court's dismissal...

Collateral Estoppel Doctrine Requires Dismissal of Delaware Derivative Action

The directors of a drug manufacturer faced several derivative lawsuits stemming from the payment of significant civil and criminal fines related to drug misbranding. Even though the company was a Delaware corporation, different shareholder groups filed separate suits in California federal court and in Delaware Chancery court. The defendants moved to dismiss both actions for failure to plead demand futility. The California federal court ruled first and dismissed the action on the merits, finding that demand upon the board would not have been futile. The Delaware court, however, held that the California judgment did not bar the Delaware action and denied the motion to dismiss. This appeal followed. The Full Faith and Credit Clause of the U.S. Constitution requires a court in one jurisdiction to give a judgment, including a federal court judgment, the same force and effect. Because a final judgment was rendered in the California action, the Delaware court should have given that judgment deference, and analyzed whether the case before it should be dismissed based on the principles of collateral estoppel under California law, not Delaware law. The appellate court held that under "this [c]ourt's precedents, the undisputed interest that Delaware has in governing the internal affairs of its corporations must yield to the stronger national interests that all state and federal courts have in respecting each other's judgments." In California, collateral estoppel requires that the issue sought to be precluded must be identical to that previously decided; it must have been actually litigated; it must have been necessarily decided, be final on the merits and the parties must be the same or in privity with each other. In this case, each element was satisfied. The issue to be decided was whether the failure to make a demand on the board was excused because demand would have been futile. The California court addressed that precise issue and, as such, the matter was litigated and a final judgment on the merits had been entered. Further, under California law and the law of many other jurisdictions, because the real plaintiff in interest is the corporation, different groups of shareholders are deemed to be in privity with each other for purposes of issue preclusion. The court also noted that there was no presumption that the California plaintiff was an inadequate representative if they failed to file a books and records action first. Therefore, the court reversed the lower court's decision and dismissed the Delaware lawsuit, putting to rest the prior division among Delaware courts on this issue. *Pyott v. Louisiana Mun. Police Employees' Ret. Sys., et al.*, 2013 Del. LEXIS 179 (Del. 2013).

The Full Faith and Credit Clause of the U.S. Constitution requires a court in one jurisdiction to give a judgment, including a federal court judgment, the same force and effect.

'Professional Services' Exclusion in D&O Policy Bars Coverage for Regulatory and Class Action Claims

In this case, an insured purchased a D&O policy with a "professional services" exclusion; however, the words were not defined. The Financial Industry Regulatory Authority (FINRA) initiated disciplinary proceedings against the insured, alleging that it misrepresented the value of certain real estate investment trust (REIT) shares sold to investors, and failed to perform adequate due diligence in marketing those shares. Subsequently, three related class action lawsuits were brought and tendered to the insurer. Coverage litigation ensued after the insurer denied coverage based on the "professional services" exclusion. The insured argued the policy was ambiguous because it contained an undefined term. The court disagreed, concluding the insured's due diligence performed in the course of providing investment advice constituted a "professional service" for purposes of the exclusion. Significantly, the court found that even if the words "professional services" were not defined, these words "should be read in light

of common speech and the reasonable expectations of a business person." The court also rejected any suggestion that the insured's activities were "ministerial" in nature because "performing a due diligence analysis and marketing financial products requires specialized knowledge and training, and is not a rote activity performed by a professional." The court highlighted that no discovery is necessary to determine whether the exclusion applied because the "actions allegedly taken by [the insured] ... fall squarely within a common-sense understanding of 'professional services.'" Accordingly, the court concluded that "[t]o hold otherwise would subject insurance companies to costly and unnecessary discovery with respect to the application of an exclusion, even though the detailed allegations in the underlying lawsuits make clear the exclusion applies." *David Lerner Assoc., Inc. v. Phila. Indem. Ins. Co.*, 2013 U.S. Dist. LEXIS 46333 (E.D.N.Y. 2013).

... "[t]o hold otherwise would subject insurance companies to costly and unnecessary discovery with respect to the application of an exclusion, even though the detailed allegations in the underlying lawsuits make clear the exclusion applies."

Insured Has Burden of Proof on Allocation; Notice to Underwriting Insufficient

The insured in this case had been sued in several matters resulting in significant settlements that exceeded its insurance tower. Certain issues remained unresolved between the insured and some of its excess carriers. It was not disputed that the underlying cases consisted of both covered and uncovered matters; however, the insured did not allocate the settlement between the two categories at the time the cases were resolved. Instead, it contended the insurance carriers bore the burden of allocation. First, the court noted that contrary to the carriers' assertions, there was no case law holding that an insured must contemporaneously allocate a settlement or risk losing insurance coverage altogether. However, the court declined to apply a split burden of proof on allocation (requiring the insured to prove the allocation between those claims falling within the insurance grant and those that did not, but requiring the carrier to bear the burden of how much should be allocated based on policy exclusions). Instead, it found that the insured had the burden of proof on allocation between covered and uncovered matters. It noted that in requiring the insured to allocate, "the [c]ourt is simply requiring [the insured] to prove how it was harmed by the insurers' breach of their policies." Further, the insured controlled the underlying litigation, negotiated the settlement, and was in a better position to know how the settling parties valued the claims at a time when the insured knew that allocation was a coverage issue. One of the excess carriers also argued that notice of the matter was not properly provided to it because the notice was never provided to its claims department. The court noted that this was a claims made and reported policy such that strict compliance with the notice condition was required. However, the question here was to whom the notice was provided, and the policy required that notice be provided to the claims department. The court determined that strict compliance with that provision was not required, but substantial compliance was and since it was undisputed that the insured did not provide notice to the claims department, the insured did not substantially comply with the notice provision. The court noted there is a reason the policies require notices be provided to the claims department, citing the proposition that "[i]t is far easier for the insured to lick a postage stamp than it is for the insurer to scour insurance applications for notice of claims." Thus, the court found the excess carrier that did not receive notice had no obligation to the insured under the policy. *UnitedHealth Group Inc. v. Columbia Cas. Co., et al.* 2013 U.S. Dist. LEXIS 59249 (D. Minn. 2013).

Prior and Pending Litigation Exclusion and Interrelated Wrongful Act Provision Bar Coverage, but Insurer's Oral Representation to Fund a Settlement May Modify Insurance Contract

In this coverage dispute, a former employee of the insured filed an administrative complaint with the New Jersey Division of Civil Rights in 2007 alleging the insured paid her less than male counterparts and terminated her in retaliation for making a complaint. Subsequently, in 2009, the former employee filed a lawsuit alleging disparate treatment based on gender and added a claim for sexual harassment. The insured's employment practices liability policy for the period of October 1, 2008 to October 1, 2009 included a prior and pending (P&P) litigation exclusion, which barred coverage for any claim made before October 1, 2008. The policy also included an "Interrelated Wrongful Acts" provision that stated "[a]ll Loss arising out of the same Wrongful Act and all Interrelated Wrongful Acts shall be deemed one Loss on account of one claim. Such Claim shall be deemed to be first made when the earliest of such Claims was first made." An "Interrelated Wrongful Act" was defined to mean "any causally connected Wrongful Act or series of the same, similar or related Wrongful Acts." The insurer denied coverage, yet agreed to cover a portion of the cost needed to retain private counsel and indemnify the insured for a settlement with the former employee up to at least $100,000 and potentially $125,000. After the insured settled the underlying lawsuit with its former employee, the insurer withdrew its offer to fund any portion of the settlement, arguing that the P&P litigation exclusion and "Interrelated Wrongful Acts" provision barred coverage. It was apparent to the court that there was "substantial overlap" between the administrative action and the subsequent state civil lawsuit. The court needed to "look no further than the complaints filed in both actions to determine that the former employee's civil suit arose from and was based upon the same set of factual allegations and claims made in her earlier administrative action." Both proceedings involved the same parties and made similar claims "rooted" in anti-discrimination law. It was evident to the court that even though the civil complaint added sexual harassment claims, it was a progression of the administrative action. Consequently, the insurer was not required to provide coverage. The court, however, concluded the insurer may have agreed to provide coverage by making oral representations that it would agree to fund a portion of any settlement, such that factual issues remained to be decided at trial. *Regal-Pinnacle Integrations Indus., Inc. v. Phila. Indem. Ins. Co.*, 2013 U.S. Dist. LEXIS 56941 (D.N.J. 2013).

The court ... concluded the insurer may have agreed to provide coverage by making oral representations that it would agree to fund a portion of any settlement, such that factual issues remained to be decided at trial.

SEC Filings	SEC Settlements
• The SEC filed insider trading charges against Scott London, former partner of **KPMG**. The SEC is seeking disgorgement, prejudgment interest, and penalties. • The SEC filed fraud charges against **Gibraltar Global Securities, Inc.**, and Warren A. Davis, its owner and president. The SEC is seeking disgorgement, prejudgment interest, and penalties.	• Final judgment on fraud charges was entered by the District Court of Columbia against Maurice G. Taylor, former CIO of **Gibraltar Asset Management Group**. Taylor was ordered to pay disgorgement of $463,785 and prejudgment interest of $50,683. • The SEC settled charges of FCPA violations against **Parker Drilling Company (Parker)**. Parker was ordered to pay disgorgement of $3,050,000 and prejudgment interest of $1,040,818. • The SEC settled insider trading charges against Mark D. Begelman, former member of the **World President's Organization**. Begelman was ordered to pay disgorgement of $14,949, prejudgment interest of $377, a penalty of $14,949, and was barred from serving as an officer or director of a public company for five years. • The SEC settled fraudulent misappropriation charges against **Windham Securities, Inc. (Windham)**, Joshua Constantin, former CEO, president and CCO of Windham; Brian Solomon, former managing director of Windham; **Constantin Resources Group, Inc. (CRG)**; and **Domestic Applications Corp. (DAC)**. Windham, Constantin, Solomon, CRG, and DAC were collectively liable for more than $2,740,000 in disgorgement, prejudgment interest and penalties.

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...the fact that News Corporation's hefty settlement was funded entirely by D&O insurance is noteworthy due to the potential in the D&O marketplace for derivative suits to represent an increasing severity risk, particularly for excess Side A insurers.

General News

Delaware Chancery Court Scrutinizes Single-Bidder Sale Process

The Delaware Court of Chancery recently declined to enjoin the sale of NetSpend Holdings, Inc. (NetSpend) to Total System Services, Inc. (TSYS) despite finding that the single-bidder sales process undertaken by the directors of NetSpend likely breached their *Revlon* duties to obtain the highest price reasonably attainable for the stockholders. Vice Chancellor Glasscock concluded that while a single-bidder strategy is not per se unreasonable, such a strategy may be deemed unreasonable in the context of a flawed sales process. In this case, the court criticized NetSpend's board for relying on a fairness opinion the court characterized as "weak" and using it as a substitute for a market check against TSYS's offer; and for entering into a merger agreement containing strong deal protections such as "Don't Ask, Don't Waive" standstill agreements and other deal lock-up provisions. Despite the deficiencies in the process noted by the court, Vice Chancellor Glasscock refused to enjoin the transaction, reasoning that the risk to the shareholders of losing what could be their only opportunity to receive a substantial premium over market for their shares outweighed the harm from the flawed sales process. Within a week of the court's decision, NetSpend announced it would adjourn its special meeting of stockholders to be held in connection with NetSpend's proposed merger with TSYS to provide additional time for unsolicited bidders to submit proposals. At the same time, the company announced certain modification to its merger agreement with TSYS in connection with a proposed settlement of *Koehler* and a companion Texas action. The court's opinion can be found at *Koehler v. NetSpend Holdings, Inc.*, 2013 Del. Ch. LEXIS 131 (Del. Ch. 2013).

D&O Insurance to Fund 'Largest Cash Derivative Settlement on Record'

In what plaintiffs' lawyers claim to be the "largest cash derivative settlement on record," News Corporation's board, led by chairman and chief executive Rupert Murdoch, recently reached a $139 million settlement with a group of U.S. shareholders. The individual defendants, current or former directors of the company, were alleged to have breached their fiduciary responsibilities in handling the widely reported phone-hacking scandal and attempted cover-up in Britain, along with an allegation that the company unethically paid $670 million in 2011 to acquire a television production company of Mr. Murdoch's daughter, who purportedly earned $250 million in the acquisition. Under the terms of the proposed settlement, News Corporation will work to strengthen its global compliance structure and corporate governance, as well as recover $139 million. Cash payments in derivative suits were once a rarity, but became more common in the wake of options-backdating scandals. While many sizeable derivative settlements and judgments have come to pass over the years, the fact that News Corporation's hefty settlement was funded entirely by D&O insurance is noteworthy due to the potential in the D&O marketplace for derivative suits to represent an increasing severity risk, particularly for excess Side A insurers. Due to the exposure this type of cash settlement presents for Side A insurers whose most significant exposure is generally an insured company's insolvency and consequent inability to indemnify its directors and officers, it is anticipated that insurers will reevaluate how they underwrite the risks associated with derivative settlements and ensure they are adequately compensated in premiums.

Cash payments in derivative suits were once a rarity, but became more common in the wake of options-backdating scandals.

Cases of Interest

Trade Practices Exclusion and Loss Carve-Outs Inapplicable to Judgment against Debt Collector

"When an individual receives a notice that violates the FDCPA or PFCEUA ... they are instantly affected and a legal injury is sustained."

This coverage dispute involved whether the plaintiffs, who were subject to unlawful debt collection practices by a bankrupt agency, could access the agency's E&O policy to recover a bankruptcy court judgment. The underlying action involved alleged violations of the Fair Debt Collections Practices Act (FDCPA), the Pennsylvania Fair Credit Extension Uniformity Act (PFCEUA), and the Pennsylvania Unfair Trade Practices Act. The carrier first argued there was no coverage based on the exclusion for "any Claim ... based upon, arising from, or in consequence of allegations of ... unfair trade practices ... or any similar provision of any federal, state, or local statutory law or common law." The court found the reference in the exclusion to state law did not necessarily implicate the FDCPA or the PFCEUA. Further, the FDCPA and PFCEUA claims were found not to be unfair trade practice statutes, meaning they were outside the ambit of that exclusion. The carrier also argued that since the bankruptcy plan absolved the agency from having to pay the judgment, there was no cognizable "Loss" under the policy. However, the court held coverage was not barred by the "absolved from payment" provision, as the plan was an agreement designed to confer the right to any insurance proceeds to the plaintiffs, and it was not an agreement designed to absolve the agency of liability altogether, but solely for debts dischargeable in bankruptcy. The carrier then argued the carve-out of "Loss" for "the return of fees or other compensation paid to the Insured" included any sums that were improperly paid by the plaintiffs to the agency after receiving illegally overbearing notices. The court rejected this argument, reasoning there was no possibility of windfall to the bankrupt agency. "Neither [the agency] nor any subsequent incarnations of its corporate persona stand to collect any of the proceeds from the policy. Rather, it is the plaintiffs who seek damages for the wrongful acts of the [agency]." Finally, the carrier argued the statutory damages under the PFCEUA constituted penalties that were excluded under the definition of "Loss." The court disagreed, holding the statutory damages sought under the PFCEUA were not excluded since the fundamental goal of the statute was to compensate those who suffer legal injury. "When an individual receives a notice that violates the FDCPA or PFCEUA ... they are instantly affected and a legal injury is sustained." *Hrobuchak v. Fed. Ins. Co.*, 2013 U.S. Dist. LEXIS 74160 (M.D. Pa. 2013).

Fraud Exclusion Bars Arbitration Award; No Coverage for Pre-Tender Fees under Duty to Indemnify Policy

An insured bank sought coverage under its D&O policy for the defense of, and an arbitration award levied against it, finding the bank committed fraud in the execution of certain loan documents. The insurer cited the policy's fraud exclusion to deny coverage. Interestingly, the fraud exclusion was changed by endorsement from a "final adjudication" trigger to an "in fact" trigger. The court held there was no coverage available for the bank, noting that "courts impose a higher standard on insurers seeking to avoid a duty to defend provision than they do on insurers seeking to avoid a duty to indemnify provision, as [the carrier] seeks to do here." The court then found, based on the plain language of the exclusion viewed in the context of the whole policy, "that it was the intent of the signatories and that it was the bank's reasonable expectation that the [p]olicy would exclude from coverage a category of acts that clearly includes facts like those contained in the [arbitrator's award]." In reaching its conclusion, the court relied on the use of "any" and "in any way involving" in the exclusion, and the modification from "final adjudication" to "in fact," to establish the intent of the modification was to adopt an expansive fraud exclusion that encompasses "as wide a range of acts as plausible." A second issue addressed by the court was whether the bank was entitled to recover the attorneys' fees and costs incurred prior to the matter being noticed to the

carrier. The policy provided "[t]he Insured shall not incur Defense Costs...without the Insurer's prior written consent." The carrier cited duty to defend cases to argue the enforceability of provisions requiring written consent prior to incurring any defense costs. In response, the bank argued "[t]he logic underlying the exclusion of pre-tender fees is inapplicable where, as here, [the carrier] owes no duty to defend and as such never undertakes [the bank's] defense." The court found the pre-tender fees were not covered, explaining that "the bank does not argue that provisions excluding pretender fees are unenforceable when there is no duty to defend, nor does it provide any reason why two parties could not assent to such a provision in a contract, as appears to be the case here." *Nat'l Bank of Cal. v. Progressive Cas. Ins. Co.*, 2013 U.S. Dist. LEXIS 48504 (C.D. Cal. 2013).

Plaintiffs Not Required to Plead Knowledge in §11 'Soft Information' Case

Plaintiffs appealed the dismissal of their securities suit under §11 of the Securities Act arguing the trial court erred in holding the plaintiffs had not adequately pled knowledge of wrongdoing on the part of the defendants. The Sixth Circuit reversed the trial court's decision, holding that because §11 is a strict liability statute, plaintiffs were not required to plead knowledge in connection with their claim. This decision is in direct conflict with Second and Ninth Circuits' decisions on the same issue. Here, the complaint alleged defendants were engaged in a variety of illegal activities, and therefore, the statements of "legal compliance" made in the registration statement upon which the plaintiffs relied were found to be material, false and misleading, and therefore in violation of §11. The complaint did not allege the defendants knew the at-issue statements were false. Defendants moved to dismiss the complaint arguing that because legal compliance statements are "soft information," i.e. matters of opinion and predictions, a plaintiff must plead knowledge of falsity. They framed the issue as a disclosure requirement and pointed to §10(b) and Rule 10b-5 cases which hold there cannot be liability for a material misstatement if a defendant was not aware there was anything further to disclose in order to correct the misstatement. Plaintiffs countered that §11 provides for strict liability, and does not require a plaintiff to plead a defendant's state of mind. The federal appellate court agreed with the plaintiffs despite decisions to the contrary noted above and distinguished §11 from §10(b) and Rule 10b-5, which require a plaintiff to prove knowledge of falsity. According to this court, §11 provides for strict liability when a registration statement "contain[s] an untrue statement of a material fact ... No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim." Given the conflicts between the circuit courts' decisions, it is likely the U.S. Supreme Court will be required to weigh in on the matter and determine which circuit has properly established the requirements for pleading §11 claims. *Ind. State Dist. Council v. Omnicare, Inc.*, 2013 U.S. App. LEXIS 10385 (6th Cir. 2013).

"No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim."

Telephone Consumer Protection Act Damages Are Insurable

The case arose out of a "blast fax" sent by an insured, an Illinois real estate agency, to approximately 5,000 fax numbers in Illinois. Several fax recipients filed a class action suit against the insured alleging violations of the Telephone Consumer Protection Act (TCPA), and ultimately represented a putative class of approximately 3,500 plaintiffs. After the insured settled the underlying suit for approximately $1.7 million, the insurer filed a coverage action arguing that the settlement represented damages that were punitive and uninsurable under Illinois law. The trial court agreed and denied coverage. The Illinois appellate court affirmed, holding that the settlement was uninsurable because the TCPA is a penal statute. "The 'actual' damages incurred by a violation of the TCPA are more in the nature of an irksome nuisance ... and [are] not meant to compensate for any actual harm." The Illinois Supreme Court rejected the appellate court's interpretation that the TCPA is punitive in nature. While recognizing that the monetary effect of an unsolicited communication is relatively minor, the court stated it is

nevertheless a compensable harm. "The harms identified by Congress, e.g., loss of paper and ink, annoyance and inconvenience, while small in reference to individual violations of the TCPA are nevertheless compensable and are represented by a liquidated sum of $500 per violation." The court acknowledged that its decision contradicted other court decisions finding the TCPA $500 damage award per statutory violation constituted punitive damages. Nevertheless, the Illinois Supreme Court held the $500 award for each violation of the TCPA is remedial and not punitive, and, therefore insurable under Illinois law. *Standard Mut. Ins. Co. v. Lay*, 2013 Ill. LEXIS 564 (Ill. 2013).

Overbilling Practices Asserted in False Claims Act Qui Tam Complaint Not a 'Professional Service'

The insured is a management services organization, which contracts with licensed health care providers and offers administrative and management services, including billing and collection services. A federal False Claims Act qui tam complaint was filed against the insured alleging it engaged in a scheme to defraud Medicaid and Medicare by over-representing the cost of services supplied to patients. Because the complaint was filed under seal as required by federal law, the insured was not immediately served; however, the insured was served with subpoenas from a federal regulatory agency seeking documents "in connection with an investigation regarding the submission of possibly false, fraudulent or improper claims." The insured tendered the subpoenas to its medical professional liability insurer for coverage. Eventually, the qui tam lawsuit was settled and the insured provided notice of that action as well. The professional liability policy provided coverage for sums the insured became legally obligated to pay as damages or claim expenses arising out of a negligent act, error or omission for claims first made during the policy period. The policy excluded from coverage any claim based upon or arising out of dishonesty or fraudulent, criminal or intentional acts, errors or omissions. The insurer disclaimed coverage for the subpoenas and qui tam lawsuit, and the insured filed a declaratory judgment lawsuit seeking damages for negligence and statutory "bad faith." The federal trial court found in favor of the insurer because "courts in this District and elsewhere have unanimously concluded that the submission of billing claims under the [False Claims Act] does not qualify as a 'professional service.'" The insured, however, argued that billing and collections were its primary services, in contrast to medical providers, in which billing is an ancillary activity. The court summarily rejected this argument because the insured filled out a policy application and told the insurer that it offered primary care as a medical outpatient facility, and the insurer issued the policy based on that representation. Moreover, the court determined a False Claims Act accusation did not fall within the policy's insuring agreement for damages arising out of a negligent act, error, or omission, because "[a] party cannot be held liable pursuant to the [False Claims Act] for mere negligence." Importantly, "there must be a knowing presentation of what is known to be false." Additionally, the court found the policy's conduct exclusion barred coverage. Consequently, the insurer had no duty to defend or to indemnify the insured. Finally, the court dismissed the negligence, "bad faith" and alleged statutory violation of Washington's Insurance Fair Conduct Act and Consumer Protection Act claims because in the absence of coverage, the insured could not demonstrate any harm, which is an essential element for recovery under the statutes. Moreover, because the insured could not demonstrate any unreasonable coverage denial or payment of benefits, the court dismissed the Insurance Fair Conduct Act and Consumer Fraud Act claims. *MSO Wash., Inc. v. RSUI Group, Inc.*, 2013 U.S. Dist. LEXIS 65957 (W.D. Wash. 2013).

... the court determined a False Claims Act accusation did not fall within the policy's insuring agreement for damages arising out of a negligent act, error, or omission, because "[a] party cannot be held liable pursuant to the [False Claims Act] for mere negligence.

Prejudice Requirement Held Inapplicable to Claims-Made Policy

This coverage dispute arose following an insured's submission of a claim to its D&O and employment practices liability insurer, which denied the claim as being untimely. The insured submitted a memorandum to its board of directors received from the claimant demanding commissions he was allegedly owed, along with subsequent lawsuits against the insured entity and its director/founder. The insured's notice to its insurer was submitted approximately four years after the memorandum was received, and three years after the first lawsuit was filed. As a result of the policy's requirement that notice be provided as soon as practicable upon the insured becoming aware of the claim, but not later than 60 days after the expiration date of the policy in place at the time the claim was made, the insurer refused coverage and this litigation ensued. The insurer argued the insured failed to notify it of the claim in a timely manner and, as a result, the claims consequently fell outside the terms of the insurance policies. The insured, on the other hand, asserted that no prejudice was suffered as a result of its failure to strictly comply with the notice provision. The court disagreed, relying heavily on established case law in Missouri substantiating "[t]he prejudice requirement is generally not held to apply to claims made policies [because] unlike an occurrence policy where the occurrence of a negligent act or omission during the coverage period triggers coverage, a claims-made policy provides coverage when the act or omission is discovered and brought to the insured's attention, regardless of the occurrence date." Based on this precedent, the court found the insurer was "not required to demonstrate that it was prejudiced by [the insured's] failure to provide timely notice under the claims-made policies," and the insured's "failure to give the requisite notice precludes it from coverage." *Secure Energy v. Phil. Indem. Ins. Co.*, 2013 U.S. Dist. LEXIS 69320 (E.D. Mo. 2013).

... the insurer was "not required to demonstrate that it was prejudiced by [the insured's] failure to provide timely notice under the claims made policies" ...

California Code Does Not Preclude Defense for Federal Criminal Actions

The former medical director of the insured hospital was indicted for his role in diverting a liver destined for a patient higher on the official transplant list to a patient much further down the list, and for covering up the incident, in violation of federal regulations governing transplants. The doctor sought a defense under the non-profit D&O policy issued to the hospital. The carrier declined to indemnify or defend him and the doctor brought suit. The carrier relied on California Insurance Code §533.5, which states: "No policy of insurance shall provide, or be construed to provide, any duty to defend ... any claim in any criminal action or proceeding or in any action or proceeding brought pursuant to [the California unfair competition or false advertising laws] in which the recovery of a fine, penalty, or restitution is sought by the Attorney General, any district attorney, any city prosecutor, or any county counsel, notwithstanding whether the exclusion or exception regarding the duty to defend this type of claim is expressly stated in the policy." The carrier asserted no duty to defend was available per the statute since it was a criminal case. The doctor disagreed, arguing the statute only prohibited a defense when the matter was brought by one of the governmental bodies listed, and did not apply to a federal criminal prosecution. After reviewing the legislative history and intent of the statute, the court determined the statute was enacted to deal with problems the state Attorney General (AG) had in settling actions under the state unfair trade practices and false advertising statutes. Because insurers were defending, the AG was not litigating with the alleged wrongdoer, and to make matters worse, the insurers refused to make the restitution payments sought in relief. Thus, the court concluded the legislature enacted the statute to prevent the use of insurance to defend criminal matters specifically identified in the statute, and not to apply in cases like that before the court here. The legislative history further proved the statute was amended over time to address unintended consequences primarily involving environmental actions pursued by state or local prosecutors. Importantly, there was never any intent expressed to apply the statute in the federal criminal context. Thus, the court held the statute did not apply to federal criminal matters such that the doctor was entitled to a defense under the policy. *Mt. Hawley Ins. Co. v. Lopez*, 2013 Cal. App. LEXIS 346 (Cal. App. 2013).

SEC Filings	SEC Settlements
• The SEC filed fraud charges against **Subaye, Inc.** and James T. Crane, former CFO. The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Crane from serving as an officer or director of a public company.	• Final judgment on fraud charges was entered by the U.S. District Court for the Southern District of New York against Richard Verdiramo, former chairman, CEO, president and CFO of **RECOV Energy Corp.**, and Vincent Verdiramo, former chairman, CEO and president. Richard Verdiramo was ordered to pay disgorgement of $145,000, prejudgment interest of $61,968, a penalty of $100,000, and was barred from serving as an officer or director of a public company for five years. Vincent Verdiramo was ordered to pay disgorgement of $462,000, prejudgment interest of $197,444, a penalty of $100,000, and was barred from serving as an officer or director of a public company. • The SEC settled fraud charges against **RINO International Corporation**, Dejun "David" Zou, CEO, and Jianping "Amy" Qiu, chairman of the board. Zou and Qiu were ordered to pay disgorgement of $3,500,000, civil penalties of $150,000 and $100,000 respectively, and were barred from serving as officers or directors of public companies for ten years. • Final judgment was entered by the U.S. District Court for the Eastern District of New York against **MedLink International, Inc. (MedLink)**; Aurelio Vuono, CEO; and James Rose, CFO. MedLink, Vuono and Rose were ordered to pay, jointly and severally, disgorgement of $149,473, prejudgment interest of $8,942, and penalties of $650,000 against MedLink, $130,000 against Vuono, and $130,000 against Rose. Additionally, Vuono and Rose were barred from serving as officers or directors of public companies.

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Pointing to the increase in retaliation claims ("nearly doubled in the past 15 years") and judicial efficiencies ("frivolous claims, which would siphon resources"), the Court's stricter standard provides employers with a means to seek early dismissal of retaliation claims.

General News

Study Finds D&O Insurance Provides Substantial Protection to Corporate and Individual Insureds

Authors Michael Klausner, Jason Hegland, and Matthew Goforth of Stanford Law recently updated earlier research in a new article titled *How Protective is D&O Insurance in Securities Class Actions? – An Update*. Based on the data, the authors conclude that D&O insurance provides "substantial protection to corporate insureds." The authors examined securities class action lawsuits filed between 2006 and 2010 and settled between 2006 and 2012. In total, there were 652 non-merger cases filed during this period, 253 of which settled, 256 of which were dismissed with prejudice or voluntarily dismissed by plaintiffs, and 119 of which are still pending. In 58% of cases, the insurer paid the full settlement; in 28% the insurer paid some of the settlement; and in 15% the insurer paid nothing. The size of the settlement was noted to be the primary factor influencing the portion of the settlement paid by insurance. Additionally, the severity of the alleged misconduct was another important factor. "Mean insurer contributions, in percentage terms, are relatively low for the smallest settlements, they then rise for middle-range settlements, and then decline as settlement sizes rise." For settlements in the lower ranges, the percentage paid by insurers probably reflects the impact of retentions. For settlements in the higher ranges, the authors put forth three potential reasons for the lower percentage paid by insurers: 1) settlements that exceed policy limits; 2) "defenses to coverage where deliberate misconduct may have been involved" and; 3) "to the extent that larger settlements are associated with parallel SEC cases, lower insurance contributions reflect a dissipation of policy limits defending those cases." The authors next addressed the frequency with which officers and directors were named as defendants, as well as how often officers and directors made out-of-pocket contributions to a settlement. Regarding frequency, CEOs are named in 93% of all cases, CFOs are named in over 80%, and outside directors are named in just under 39%. With respect to out-of-pocket payments, no case resulted in an out-of-pocket payment by an outside director, and officers contributed to 2% of settlements (0.77% of cases filed). Finally, the authors compared out-of-pocket payments made by officers in class actions with penalties the SEC imposed on the same individuals in parallel cases. The comparison revealed that "[i]n the vast majority of cases, individual defendants are penalized severely in the SEC action but bear no liability in the class action." 65 pairs of parallel class actions and SEC enforcement actions were examined. In 60 of the 65 cases, the SEC imposed serious penalties, and among those cases, there were only five that resulted in an officer making an out-of-pocket payment in the parallel class action. The authors conclude, based on a comparison of settlements of cases filed from 2006 through 2010 with those from 2000 through 2005, "there appears to have been a decline in out-of-pocket payments by officers and directors over the past decade."

"Mean insurer contributions, in percentage terms, are relatively low for the smallest settlements, they then rise for middle-range settlements, and then decline as settlement sizes rise."

Delaware Forum Selection Bylaws are Enforceable

Chancellor Strine wrote a much anticipated opinion in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation* and *Iclub Investment Partnership v. FedEx Corporation*, which rejected legal challenges to the validity of director-adopted bylaw provisions mandating Delaware as the exclusive forum for certain types of stockholder litigation. Simply put, the Delaware Court of Chancery concluded that forum selection bylaws adopted by the Chevron and FedEx boards of directors are statutorily and contractually valid. In merger litigation, the plaintiffs' bar has aggressively filed suits against Delaware corporations in numerous other state and federal courts. The prospect of Delaware corporations defending and resolving multi-jurisdictional litigation has proven challenging and burdensome. To address this problem, more than 250 publically traded corporations have recently adopted forum selection bylaws mandating certain claims against the corporation and its directors and officers, including stockholder derivative suits and fiduciary claims, can only be litigated in the entity's state of incorporation. Chancellor Strine highlighted that Chevron's board adopted the forum selection bylaws due to concerns surrounding "the inefficient costs of defending the same claim in multiple jurisdictions" and to "minimize or eliminate the risk of what they view as wasteful duplicative litigation." Chancellor Strine noted that bylaws may contain any provision relating to "the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors officers and employees." Strine also noted the Delaware General Corporation Law permits directors to unilaterally adopt and revise bylaws. Consequently, "when investors bought stock in Chevron and FedEx, they knew ... the certificates of incorporation gave the board the power to adopt and amend bylaws unilaterally." The Chancellor summarily rejected institutional plaintiffs' contention that the bylaws were unenforceable because the shareholders did not adopt them. To this end, Chancellor Strine highlighted that "a forum selection clause adopted by a board with the authority to adopt bylaws is valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses." Aon will continue to monitor this issue, as it will be interesting to see if other courts follow the Delaware Chancery Court's position since a conflict already exists with two federal courts in California that have refused to enforce similar forum selection bylaw provisions.

... "a forum selection clause adopted by a board with the authority to adopt bylaws is valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses."

Cases of Interest

U.S. Supreme Court Makes Two Employer-Friendly Decisions under Title VII

In two separate 5-4 decisions, the U.S. Supreme Court issued opinions affecting employers where employees allege unlawful retaliation or harassment under Title VII of the Civil Rights Act of 1964. The first case involved an African-American catering assistant alleging racially hostile conduct and retaliation by a fellow employee. The parties did not agree on the characterization of the supervisory status of the alleged harasser. Defining "supervisor" was decisive because precedent made a distinction regarding the scope of liability for employers based on whether the harasser is a co-worker or supervisor. If the harasser is a co-worker of the victim, the employer is liable for the harassment only if the employer's own negligence contributed to it. But if the harasser is a supervisor, the employer may be liable for the harassment even if it has done nothing negligent. The Court rejected the definition of "supervisor" advocated in the dissenting opinion and the EEOC guidelines, which connect "supervisor" status to the ability of the individual to exercise significant control or direction over a co-worker's daily work. Instead, the majority ruled in favor of the more definitive test based upon a finding of some "tangible employment action." To be considered a supervisor, the Court found the harassment has to culminate "in a tangible employment action"—that is, "a significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits." In this case, because there was no evidence the harasser had the authority to fire or demote her, much less directed the victim's day-to-day activities or set her work schedule, there was no "supervisor" status for purposes of determining the employer's vicarious liability under Title VII. The second case involved a physician alleging he was retaliated against when his supervisor prevented him from being hired as a staff physician because of his complaints against that superior of alleged racially and religiously motivated discriminatory harassment. The appellate court upheld the trial verdict for the plaintiff holding the employee only needed to prove that retaliation was a "motivating factor" for the adverse action taken against him. The Supreme Court disagreed, finding that to successfully prosecute a retaliation claim under Title VII, a plaintiff must satisfy the higher "but-for" causation standard, rather than the lesser "motivating factor" test which only requires an employee to show the motive to retaliate was one of the employer's motives, even if not the decisive factor. The heightened "but-for" standard requires the alleged victim to prove the employer would not have made the alleged retaliatory employment action but for the desire to retaliate against the employee. Pointing to the increase in retaliation claims ("nearly doubled in the past 15 years") and judicial efficiencies ("frivolous claims, which would siphon resources"), the Court's stricter standard provides employers with a means to seek early dismissal of retaliation claims. The first case can be found at *Vance v. Ball State University*, 2013 U.S. LEXIS 4703 (2013); and the second at *University of Texas Southwestern Medical Center v. Nassar*, 2013 U.S. LEXIS 4704 (2013).

Defining "supervisor" was decisive because precedent made a distinction regarding the scope of liability for employers based on whether the harasser is a co-worker or supervisor.

Guilty Plea Triggers Conduct Exclusion

This case involved a life insurance agent who sought coverage under an insurance professionals errors and omissions policy for two civil actions brought against him alleging misrepresentations made in connection with the sale of stranger-oriented life insurance policies. In addition to the civil suits, the agent was indicted on multiple counts of insurance fraud and grand theft. He pleaded "guilty/best interest" to certain charges brought against him. The carrier requested the court find it had no duty to defend the agent in the civil actions, citing the conduct exclusion, which provided that the carrier would not defend a claim (or pay damages or expenses): "based upon, arising out of, directly or indirectly relating to or in any way involving ... conduct which is fraudulent, dishonest, criminal, willful,

malicious, intentionally or knowingly wrongful, or otherwise intended to cause damage or injury to personal property; however, this exclusion shall not apply ... unless there is a finding or adjudication in any proceeding of such conduct or an admission by an Insured of such conduct." The court held the carrier was required to establish the conduct in question was criminal and sufficiently related to the claims in the underlying lawsuits to implicate the exclusion. Thus, it considered both the civil claims and the crimes of which the agent was convicted. Based on facts contained in the record in the criminal case, it was clear to the court that the civil cases for which the agent sought a defense arose from the exact same misrepresentations which formed the basis of the agent's guilty plea in the criminal action. Moreover, since the exclusion contained broad prefatory language, the court found the misrepresentations made in the matters were related under the terms of the policy. Finally, the guilty plea was considered an adjudication, meaning the conduct exclusion applied and the carrier had no duty to defend the agent in the civil actions. Certain Interested Underwriters at Lloyd's, *London v. Axa Equitable Life Ins. Co.*, 2013 U.S. Dist. LEXIS 85444 (S.D. Fla. 2013).

Narrow Wording of Professional Services Exclusion Saves Coverage

This coverage dispute arose following the filing of numerous lawsuits against an insured for injuries caused by defective medical devices manufactured by the insured, and for the fraudulent transfer of assets in an attempt to hide its remaining assets from creditors. The claims addressed by the court in this case were brought by physicians against directors and officers of the insured for promoting use of its products without advising of the adverse effects which resulted in injuries to patients and damage to the physicians' reputations. The insured sought bankruptcy protection and looked to its D&O insurer for coverage for the lawsuits. The insurer denied coverage, asserting the claims were not covered due to the "professional services" exclusion, or the exclusion for bodily injury. The court disagreed, finding the underlying claims fell within the insuring agreement, and neither exclusion was applicable. In reiterating the requirement that the insurer establish its interpretation of an exclusionary clause as the only reasonable one, the court found the carrier's arguments unavailing. The term "professional services" was not defined in the policy, so the court applied its commonly understood meaning, i.e. "a service arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill and the labor or skill involved is predominately mental or intellectual, rather than physical or manual." With respect to the activities performed by the insured here, the court found the marketing and delivery of product samples to physicians were not "professional services." The court also rejected the insurer's attempt to rely on the bodily injury exclusion, reasoning that even if the claims asserted by the underlying physician plaintiffs derived from bodily injury claims, the wording of the exclusion did not encompass the underlying business tort claims. "Had [the insurer] sought to exclude losses caused by claims that, although not claims for bodily injury, bear some relationship to a claim for bodily injury, it could have used broader language; for example, the policy could have excluded losses on account of claims arising from or arising out of bodily injury." *Scottsdale Ins. Co. v. Coapt Systems, Inc.*, 2013 U.S. Dist. LEXIS 86414 (N.D. Ca. 2013).

"... [the insurer] could have used broader language; for example, the policy could have excluded losses on account of claims arising from or arising out of bodily injury."

$160 Million 'Disgorgement' Settlement with SEC Covered under D&O Program

Prior to its demise, Bearn Stearns & Co. (Bear Stearns) received Wells notices from the Securities and Exchange Commission (SEC) indicating its intent to commence civil proceedings for violation of federal securities laws. While disputing the allegations of facilitating late trading and deceptive market timing on behalf of customers, Bear Stearns entered into a settlement with the SEC whereby it did not admit or deny the allegations, but agreed to pay $160 million in disgorgement, and a $90 million penalty. Not surprisingly, private class action lawsuits followed the SEC case, and resulted in a settlement of $14 million along with $40 million in defense costs. Indemnification was then sought for all such amounts, excluding the $90 million

penalty, from its insurers. All of the carriers on the D&O program denied coverage for the $160 million portion labeled as disgorgement per the agreement with the SEC and this case ensued. Reversing the decision of the intermediate appellate court, New York's highest court upheld coverage for the $160 million payment. Specifically, the court found public policy did not preclude coverage for payment of the amount labeled disgorgement because the SEC Order did not conclusively establish the $160 million payment was predicated on funds Bear Stearns improperly earned as a result of its securities violations. In fact, the evidence revealed the vast majority of illicit profits resulting from the securities violations were made by institutional investor customers of Bear Sterns, with the latter only being rewarded in the form of its commissions. As such, public policy did not preclude coverage, nor did exclusionary provisions barring coverage for ill-gotten gains. *J.P. Morgan Securities Inc. v. Vigilant Ins. Co.*, 2013 N.Y. LEXIS 1465 (Ct. App. 2013).

... public policy did not preclude coverage, nor did exclusionary provisions barring coverage for ill-gotten gains.

Tenth Circuit Broadly Interprets Sarbanes Oxley's Whistleblower Provisions

A Lockheed Martin Corporation (Lockheed Martin) employee filed a Sarbanes Oxley Act (SOX) whistleblower complaint with the Occupational Safety and Health Administration (OSHA) alleging that Lockheed retaliated against her for reporting her supervisor for suspected fraud and then constructively discharged her. Specifically, the employee alleged that she encountered several negative employment actions shortly after she complained to Lockheed's Vice President of Human Resources that her supervisor had initiated sexual relationships with several soldiers using Lockheed's pen pal program, used company funds to purchase a laptop computer for one soldier, and to "travel to welcome-home ceremonies for soldiers on the pretext of business while actually taking soldiers to expensive hotels in limousines for intimate relations." OSHA dismissed the complaint because her reports were not subject to SOX protection. The employee objected to OSHA's decision and requested a hearing before an administrative law judge (ALJ), who concluded that the employee proved by a preponderance of the evidence that reporting her supervisor for suspected mail and wire fraud was a contributing factor in the adverse job actions she suffered. Lockheed took issue with the ALJ's findings and asked the U.S. Department of Labor's Administrative Review Board's (ARB) to review the matter. The ARB affirmed the ALJ's decision and Lockheed filed an appeal to the Tenth Circuit Court of Appeals, which affirmed the ARB's decision that Lockheed Martin violated SOX when it constructively discharged an employee after she had engaged in protected activity. The court first held that "[t]he plain, unambiguous text of § 1514A(a)(1) establishes six categories of employer conduct against which an employee is protected from retaliation for reporting: violations of 18 U.S.C. § 1341 (mail fraud), § 1343 (wire fraud), § 1344 (bank fraud), § 1348 (securities fraud), any rule or regulation of the SEC, or any provision of Federal law relating to fraud against shareholders." Second, the Tenth Circuit gave "deference" to the ARB's findings and held that the employee's complaints fell squarely within the protection of SOX and summarily rejected Lockheed's argument that SOX § 1514A(a)(1) protected only employee complaints related to fraud against shareholders. Finally, the court noted that the ALJ's decision on the whistleblower protection was grounded heavily and explicitly on a credibility determination and the Tenth Circuit refused to take the "extraordinary step" of disturbing this determination. Similarly, the Tenth Circuit concluded that the ARB's constructive discharge conclusion was amply supported by the record developed before the ALJ. Accordingly, under the substantial evidence standard of review, Lockheed's arguments were insufficient to overturn the ARB's factual findings. *Lockheed Martin Corp. v. Admin. Rev. Bd.*, 2013 U.S.App. LEXIS 11159 (10th Cir. 2013).

Ninth Circuit Holds *Moench* Presumption Inapplicable When Pension Plans Did Not Require or Encourage Investment in Company Stock

Current and former employees of Amgen, Inc. (Amgen), a pharmaceutical company, participated in the company's two 401(k) plans, which both included an employer stock fund. Plan participants brought suit alleging the company used improper marketing strategies that concealed potentially adverse effects of its drugs and plan fiduciaries knew or should have known the undisclosed truth concerning the safety of Amgen's products. Claimants' further alleged plan fiduciaries acted imprudently in continuing to permit plan participants to invest in company stock in light of the foregoing. Eventually, the company's strategies were brought to light, which resulted in the Food and Drug Administration issuing a "black box" warning for off-label use of the drugs, Congressional subcommittees investigating the drugs to restrict their use, and expanded warnings concerning their use. Consequently, Amgen's stock lost significant value. The trial court dismissed the case, ruling that Amgen and its fiduciaries were entitled to a presumption that their actions were prudent in keeping Amgen stock as an investment option. The employees appealed and the U.S. Court of Appeals for the Ninth Circuit reversed the dismissal. Previous editions of the *Month in Review* have discussed the *Moench* presumption, which applies "when plan terms require or encourage the fiduciary to invest primarily in employer stock." If they do, a fiduciary is entitled to a rebuttable presumption that offering company stock as an investment option was prudent. A few years ago, the Ninth Circuit adopted the presumption in *Quan v. Computer Sciences Corp.* On appeal, Amgen argued it was entitled to a presumption of prudence because the plans encouraged investment in Amgen stock because the company referred expressly to it as a permissible investment. Specifically, the Amgen plan terms stated, "All contributions to the Plan ... shall be invested as provided under the terms of the Trust Agreement, which may include provision for the separation of assets into separate Investment Funds, including a Company Stock Fund." Importantly, the Ninth Circuit determined there was "no language in the Plans requiring that a Company Stock Fund be established as an available investment for plan participants," and no "language in the Plans requiring that a Company Stock Fund, once established, be continued as an available investment." Accordingly, the Ninth Circuit concluded the plan fiduciaries were not entitled to a presumption of prudence because the plan permitted, and did not require, company stock to be an investment option. Because the plan language stated that fiduciaries "may offer a stock" the Ninth Circuit concluded this statement did not equate to "encourag[ing]" investment in the stock. Finally, the Ninth Circuit concluded that Amgen was a proper defendant because it was not clear if the employer was a fiduciary. *Harris v. Amgen, Inc.*, 2013 U.S. App. LEXIS 11223 (9th Cir. 2013).

... the plan fiduciaries were not entitled to a presumption of prudence because the plan permitted, and did not require, company stock to be an investment option.

Excess Coverage Triggered When Liability Payments, Not Obligations, Reach Attachment Point

In this coverage dispute, the individual directors and officers sought a determination that coverage under its high-layer excess D&O policies were triggered once the total amount of defense and/or indemnity obligations reached the attachment point of the respective policies. Here, the insureds' first, third and fourth excess carriers ceased operations, and liquidated their assets. The policy language at issue stated excess liability coverage shall attach only after underlying insurance had been exhausted, and that exhaustion occurs "solely as a result of payment of losses thereunder." The insureds argued this language only required the individuals' defense and indemnity obligations reach the attachment point in order to trigger the excess coverage. In contrast, the insurer argued the excess liability coverage was only triggered when liability payments reached the respective attachment point. The court found for the insurers, reasoning that "the plain meaning of the phrase 'payment of losses' refers to the actual payment of losses suffered by the Directors – not the mere accrual of losses in the form of liability." According to the court, "'obligations' are not synonymous with 'payments' on those

obligations," and "[t]o hold otherwise would make the 'payment of' language in these excess liability contracts superfluous." The court noted that denying the insureds' request did not require a ruling on whether the underlying insurers, as opposed to the insured, were required to make payments; but then went on to say in a footnote that "requiring nonoperational insurance companies to make payments as a conditional precedent to the attachment would be odd ..." *Mehdi Ali v. Fed. Ins. Co.*, 2013 U.S. App. LEXIS 11384 (2nd Cir. 2013).

SEC Filings	SEC Settlements
• The SEC filed illegal stock offering and insider trading charges against **Laidlaw Energy Group**, and Michael B. Bartoszek, CEO. The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Bartoszek from serving as an officer or director of a public company. • The SEC filed fraud charges against **Gibraltar Global Securities, Inc.**, and Warren A. Davis, owner and president. The SEC is seeking disgorgement, prejudgment interest, and penalties	• Final judgment on fraud charges was entered by the U.S. District Court, Central District of California, against Christopher Scott, former CCO of **Westcap Securities, Inc.** Scott was ordered to pay disgorgement of $112,000, prejudgment interest of $12,000, a penalty of $75,000, and was barred from serving as an officer or director of a public company for five years. • Final judgment on fraud charges was entered by the U.S. District Court, Northern District of Illinois, against two executives of **Nicor, Inc.** Kathleen Halloran, former CFO, was ordered to pay disgorgement of $177,065 and prejudgment interest of $114,012. George Behrens, former treasurer, was ordered to pay disgorgement of $87,980, and prejudgment interest of $64,726. • The SEC settled insider trading charges against Bruce W. Tomlinson, former VP of finance, principal accounting officer, and controller of **InterMune, Inc.** Tomlinson was ordered to pay a penalty of $616,000 and was barred from serving as an officer or director of a public company for five years. • Final judgment on fraud charges was entered against **China Natural Gas, Inc. (China Natural)**, and Qinan Ji, its chairman and former CEO. China Natural was ordered to pay a penalty of $815,000. Ji was ordered to pay a penalty of $100, and was barred from serving as an officer or director of a public company for ten years.

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Due to the collateral consequences of criminal actions, the DOJ and SEC appear to both agree Deferred Prosecution Agreements and Non-Prosecution Agreements strike a critical balance between punishment and practicality.

General News

Mid-Year Securities Update Reveals Increased Use of Deferred and Non-Prosecution Agreements

Federal securities class action filings remain at historically low levels through the first half of 2013, with 74 filed in federal court during that time. The decrease is part of a multiyear trend, where filings spiked in the aftermath of the credit crisis and have steadily declined since 2011. No new credit crisis cases have been filed this year and only two cases have been filed regarding Chinese issuers listed on U.S. exchanges. Another reason for the decline is that cases related to mergers and acquisitions are now largely being filed in state courts. In addition to the foregoing, increased use of Deferred Prosecution Agreements (DPAs) and Non-Prosecution Agreements (NPAs) are being used with greater frequency as a vehicle for prosecutors and companies alike to resolve allegations of corporate wrongdoing outside of the courts. In the two decades since their emergence, they have risen in prominence, frequency and scope, and are now a mainstay of the U.S. corporate enforcement regime. Practitioners and commentators alike see them as a middle ground between exclusive civil enforcement and criminal charges. Since 2000, the DOJ has entered into 257 publicly disclosed DPAs or NPAs with monetary recoveries related to those cases totaling over $37 billion. Due to the collateral consequences of criminal actions, the DOJ and SEC appear to both agree DPAs and NPAs strike a critical balance between punishment and practicality. The SEC's newly confirmed chair, Mary Jo White, explained they are designed to be tough in terms of monetary sanctions, but can enable companies to avoid criminal charges that either amount to a death sentence or have far-reaching collateral consequences for shareholders, employees and the general public. Lastly, while no statutes address judicial oversight of DPAs or NPAs, numerous courts have recently begun to evaluate the agreements to ensure they serve the public's interest. For example, DPAs entered into by WakeMed and HSBC resulted in hearings before the respective federal courts in which they were filed, with the companies being forced to establish support for the agreements prior to judicial approval. In sum, the increased use and flexibility of DPAs and NPAs indicate they are here to stay and serve as an effective enforcement tool.

Practitioners and commentators alike see NPAs and DPAs as a middle ground between exclusive civil enforcement and criminal charges.

Cases of Interest

Claims Made and Reported Provisions Enforced to Deny Coverage Despite Policy Renewal

... "conceptual framework [applicable to claims-made-and-reported policies] applies where a policy is renewed, as well as when it is not, since each policy year represents an agreement as to a specific period during which claims made and reported will be covered."

The insured sought coverage under a claims-made-and-reported errors and omissions (E&O) policy for a claim made during one policy period and reported to the carrier during the subsequent policy period. The insured was covered under a series of policies renewed one after the other, each of which contained an extended reporting period (ERP); however, according to the terms of the policy, the ERP was inapplicable in the event of renewal. The insured argued that either all policies should be treated as a single continuous policy, or the reporting period for the 2009 policy should be extended into the 2010 policy period. The carrier argued that the renewal of a claims-made-and-reported policy does not modify the requirement that claims be reported in the same policy period in which they are received unless an ERP applies. The court held that the claim was not covered under either the prior or the renewal policy as a result of it being reported late under the prior policy and the claim having been made during the prior policy so as to fall outside of coverage under the renewal. The court followed the majority rule, and adopted the reasoning of a prior case which held a claim was not covered under the same fact pattern because the "conceptual framework [applicable to claims-made-and-reported policies] applies where a policy is renewed, as well as when it is not, since each policy year represents an agreement as to a specific period during which claims made and reported will be covered." *GS2 Eng'g & Envtl. Consultants, Inc. v. Zurich Am. Ins. Co.*, 2013 U.S. Dist. LEXIS 95137 (D.S.C. 2013).

Coverage Barred for Qui Tam Action by Prior and Pending Litigation Exclusion

A Pennsylvania court recently granted a D&O insurer's motion for summary judgment holding that coverage is barred for the defense costs incurred by an insured in connection with a qui tam action by virtue of the policy's prior and pending litigation exclusion. In 2006, a sealed qui tam complaint was filed against the insured alleging violations of the False Claims Act. The insured first learned of the action around 2009 through certain "back channels," including obtaining a redacted copy of the complaint from an online docketing system. Notice was given to the insurer of the redacted, unserved version of the complaint in 2009 under a policy in effect for the period May 1, 2009 to May 1, 2010. The complaint was eventually unsealed in December 2009 and the insured was served on January 5, 2010. The insurer denied the claim on the grounds that 1) the claim was first made prior to the inception date of the policy; and 2) the prior and pending litigation exclusion operated to bar coverage. The court disagreed with the insurer on the issue of late notice finding that a "Claim" was not made until service was effected upon the insured, which occurred in the policy year the claim was noticed. It nevertheless found the insurer could deny coverage for the claim based on the policy's prior and pending litigation exclusion. The exclusion states coverage is precluded for, among other things, litigation commenced on or before a certain effective date, which was determined by the court to be May 1, 2007, the date the insured first purchased primary D&O coverage from the insurer. Because the qui tam complaint was filed before the effective date, the court denied coverage for the claim. *AmerisourceBergen Corp. v. ACE Am. Ins. Co.*, 2013 Phila. Ct. Com Pl. LEXIS 249 (2013).

Court Rescinds E&O Policy Because Oral Suggestion to Settle a Potential Suit Not Disclosed on Policy Application

Suit was filed against an insured mortgage finance company seeking damages for alleged faulty appraisals and high loan values. The plaintiffs were represented by an attorney who also represented a second couple possessing identitical claims. During settlement negotiations on behalf of the first couple, the attorney made an oral suggestion that the insured also settle with a second couple, although the second couple had not initiated litigation. Eventually, the

mortgage finance company only settled the first couple's claims. After the settlement, the company submitted an application to purchase an errors and omissions (E&O) insurance policy. The application asked if the mortgage finance company had knowledge or information of any "act, error or omission which might reasonably be expected to give rise to a claim(s), suit(s), investigation(s) or action(s)." The application also asked the insured to identify "any claim(s), suit(s), demands for arbitration, or administrative/regulatory actions" pending prior to the application. On the application, the insured listed several actions it was aware of, but failed to include the second couple's settlement overtures. Following issuance of the policy, the second couple filed a class action suit against the insured. The insurer denied the claim and sought to rescind the policy because the attorney's oral suggestion to settle with the second couple was a "claim" within the meaning of the application, and the insured's failure to identify the claim on the application constituted a material misrepresentation. The court found in favor of the insurer, reasoning that the oral suggestion was a "claim" or a potential claim within the meaning of the application, and that the failure to identify it as such was a material misrepresentation. Importantly, the policy application did not define the word "claim." Therefore, the court applied an "ordinary and customary meaning" of "claim," which meant simply a "demand for something as rightful or due." Although the court mentioned that the oral suggestion of settlement may or may not be construed as a "demand," the court concluded it was not necessary to decide this issue because the policy application only asked the mortgage finance company to identify "any act, error or omission which might reasonably be expected to give rise to a claim." Because prior to completing the application, the insured had "knowledge of activity that might reasonably give rise to a claim," the court concluded that the mortgage finance company's failure to truthfully answer this question was a misrepresentation. Significantly, the court concluded that the misrepresentation was material because had the insurer "known about the [non-settling couple's] claims ... it would not have agreed to issue the [policy], or would not have issued the [policy] on the same terms and conditions, or for the same premium." *Prosperity Mortg. Co. v. Certain Underwriters at Lloyd's, et al.*, 2013 U.S. Dist. LEXIS 98286 (D.Md. 2013).

The insurer denied the claim and sought to rescind the policy because ... the insured's failure to identify the claim on the application constituted a material misrepresentation.

Insurer Barred from Bringing Action against Independent Counsel

In a recently published decision, the California Appeals court held an insurer cannot seek reimbursement of defense fees directly from an insured's independent (Cumis) counsel. At first, the insurer disclaimed coverage under a general liability policy for a number of business-related lawsuits; but after being sued, it reconsidered its position and agreed to provide its insureds with a defense subject to a reservation of its rights. The insurer refused, however, to pay fees and costs incurred prior to its revised coverage determination or to pay for independent counsel. The insureds argued the insurer owed a duty to defend from the initial tender, including a duty to provide independent counsel. The trial court granted the insureds' motion and ordered the insurer to pay all outstanding invoices and all future reasonable and necessary defense fees. The trial court further held the insurer was not entitled to financial protections afforded under California Civil Code section 2860 because the insurer "had breached and continues to breach its defense obligations." The insurer then brought a cross-complaint against the insureds and their independent counsel seeking reimbursement of fees and costs it deemed excessive, unreasonable and uncovered. The court examined whether the insurer had a quasi-contractual right to maintain an action against the insureds' independent counsel. The court found the insurer did not, reasoning that by breaching its duty to defend, the insurer forfeited all rights to control the defense of the actions, including with respect to fee arrangements and strategy. "To hold otherwise would effectively afford the insurer that has waived the protections of section 2860 through its own wrongdoing more rights in a fee dispute with independent counsel than the insurer that has not waived such protections." The court underscored that while independent counsel may owe certain limited duties to an insurer, independent counsel hired by an insured represents the insured and the insured alone. *Hartford Casualty Ins. Co. v. J.R. Marketing, L.L.C.*, 2013 Cal.App. LEXIS 455 (Cal. App. 2013).

Award of Attorney's Fees in Merger Objection Suit Determined by 'Lodestar' Method Covered Despite Policy Exclusion for Punitive or Multiplied Damages

The Seventh Circuit upheld the trial court's decision rejecting an insurer's argument that an award of fees to plaintiffs' attorneys calculated using the "lodestar" method fell within the exclusion for civil or criminal fines or penalties, punitive or exemplary damages, or the multiplied portion of multiplied damages. Merger litigation brought by the shareholders of the target company contested the adequacy of a proxy statement which was followed by a preliminary injunction to stop the vote. Ultimately, a third party tender offer increased the value of the deal and the merger was consummated. The shareholder's attorneys then sought an award of fees and were awarded $3,150,000 by the court. In using the lodestar method, the court calculated fees of $630,000 (1,400 hours at $450 per hour) multiplied by five, to reflect the risk of nonpayment and "an exceptionally favorable result." The insurer brought a declaratory suit claiming "Loss" under the policy was limited to the $630,000, and the remainder constituted multiplied damages excluded by the policy. The appellate court determined that neither Massachusetts nor federal securities law defines attorneys' fees as damages, and in both state and federal proceedings, fees are treated as costs. Moreover, the insurer could have given the term "damages" a more comprehensive meaning, but did not. Rather, the insurer unambiguously defined the word "damages" broadly enough to include attorneys' fees; noting that the very clause on which the insurer relied uses "loss" and "damages" as distinct concepts. The court found that "adversaries' attorneys' fees in commercial litigation are not remotely like punitive damages, trebled damages, or criminal fines and penalties. A multiplier of hourly rates provides compensation for the attorney's risk. That does not entail moral hazard, which is risk-taking by the insured, induced by the insurance." Accordingly, the exclusion did not preclude coverage for the lodestar multiplier used in calculating the award of fees to plaintiff's attorneys. *Carolina Cas. Ins. Co. v. Merge Healthcare Solutions, Inc.*, 2013 U.S. App. LEXIS 14342 (7th Cir. 2013).

The court found that "adversaries' attorneys' fees in commercial litigation are not remotely like punitive damages, trebled damages, or criminal fines and penalties."

Insurer's Counterclaims for Rescission and Declaratory Judgment Barred by FIRREA

In this coverage dispute, the insurer issued a financial institution fidelity bond and a D&O insurance policy to a bank after its CEO signed a renewal application in which the bank denied knowing of "any claim that could reasonably be expected to give rise to a future liability or bond loss." Later, facts uncovered that the CEO and a bank director authorized loans benefiting the CEO and director at the bank's expense. State regulators closed the bank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. After the insurer refused coverage under the fidelity bond, the FDIC filed suit for breach of contract. The insurer then asserted various counterclaims to rescind the bond and D&O policy, and sought declaratory judgment on coverage. The FDIC sought dismissal of the insurer's counterclaims on the grounds they were barred by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). The FDIC, as the appointed receiver for a failed bank, has broad authority under FIRREA. Accordingly, an insurer cannot take any action to restrain or affect the FDIC's exercise of its powers or functions, and in this instance, the FDIC's ability to assert future claims against the insurer. The court decided not to address the insurer's declaratory judgment motion because it would address these issues when it ruled on the FDIC's affirmative claim. The court acknowledged that "dismissing [the insurer's] declaratory-judgment counterclaims deprives it of a remedy that is traditionally available to insurers asked to defend lawsuits for which there is no coverage," concluding FIRREA did not allow it to "balance the relative interests of the FDIC and the party seeking non-monetary relief." The court also held that the insurer's counterclaims were barred because of the FIRREA mandate that it failed to exhaust its administrative remedies. The court summarily rejected the insurer's contention that exhaustion is only required when dealing with creditors and did not apply here because the insurer was "responding defensively to the FDIC's complaint." The court did, however, permit the insurer to assert as an affirmative defense that the bond was "unenforceable and/or void *ab initio*." *FDIC, as Receiver for Wheatland Bank v. OneBeacon Midwest Ins. Co.,* 2012 U.S. Dist. LEXIS 94922 (N.D. Ill. 2012).

Insured's Failure to Prove Proper Allocation of Covered and Uncovered Claims Results in Victory for Insurer

This coverage dispute arose following the settlement of various class action lawsuits against an insured alleging underpayment of medical claims. The insured sought defense and indemnity coverage from its professional liability insurers. The court found that the breach of contract claims were excluded pursuant to the contract exclusion but that certain other causes of action for RICO violations were not excluded. The settlement was not apportioned between covered and uncovered claims, and the insured did not provide any expert testimony or provide evidence through a claims examiner regarding its view of apportionment. Instead, the insured argued the insurer should bear the burden of proof as to what portion of the total claim should be excluded from coverage. The court disagreed, noting the insured has better access to the relevant information, including the strength of the evidence relating to each set of claims and if the overall amount could be divided into categories of covered and uncovered claims. Here, because the parties involved were all sophisticated entities and the insured was in control of the litigation and settlement negotiations, the court found it was most logical to place the burden of proof on how much of the settlement constituted covered claims versus uncovered claims on the insured. The court further noted statements by counsel in the underlying litigation did not support the ratio of covered to uncovered claims sought by the insured, as the covered exposure was not addressed in any meaningful way and the settlement was more focused on the non-covered exposure. Thus, the court placed the burden on the insured to prove the allocation between covered and uncovered claims, and because the insured failed to prove that allocation, the carrier was not required to contribute to the underlying settlement. *Exec. Risk Indem., Inc. v. Cigna Corp.*, 2013 PA Super. LEXIS 1662 (Pa. Super. 2013).

... the court placed the burden on the insured to prove the allocation between covered and uncovered claims ...

Delaware Supreme Court Reiterates that Master Limited Partnerships are Permitted to Contractually Define Fiduciary Duties

The Delaware Supreme Court recently affirmed prior decisions holding that limited partnerships may eliminate or establish the extent of fiduciary duties in their partnership agreements, with the exception of the implied contractual covenant of good faith and fair dealing. The court held that as long as the contractual fiduciary duties modifying the statutory default fiduciary duties are unambiguous, clear and express, they will be enforced. The underlying transaction involved a merger of a publicly traded Delaware limited partnership with its general partner's controller. The plaintiff, a limited partner, alleged the general partner, its controller, and directors breached contractual duties imposed by the limited partnership agreement concerning the merger. The court affirmed the dismissal by the Court of Chancery, highlighting that the limited partnership agreement removed the statutory default fiduciary duties with a contractual duty which is satisfied if the conflicts committee of the board of directors of the general partner approves the underlying transaction in "good faith," as defined by the limited partnership agreement. The court concluded the contractual "good faith" standard under the limited partnership agreement required a subjective belief that the proposed action was in the best interests of the limited partnership. To meet this burden, a plaintiff must demonstrate either: 1) the conflicts committee believed it was acting against the limited partnership's best interests when approving the merger; or 2) the conflicts committee consciously disregarded its duty to form a subjective belief that the merger was in the limited partnership's best interests. The Delaware Supreme Court also concluded that it would take an extraordinary set of facts to meet this burden, and plaintiff failed to do so. This decision provides another illustration that Delaware courts will not introduce tort or corporate standards of conduct in situations where a limited partnership agreement amends statutory default duties and sets forth clear contractual standards in place thereof. *Allen v. Encore Energy Partners, L.P.*, 2013 Del. LEXIS 378 (Del. 2013).

D&O Insurer Absolved of Obligation to Pay Fee Award When Underlying Claim Not Covered

Whether coverage exists for fee awards when an underlying cause of action is not covered is a frequently debated topic which formed the heart of this dispute following an insurer's denial of coverage for an award that was part of a settlement in a breach of contract suit. In the underlying action, an actor sued his labor union alleging it had collected over $8 million in royalties that should have been distributed to its members. The labor union's D&O insurer agreed to cover defense costs, but disclaimed any indemnity coverage obligations. The parties in the underlying case entered into a settlement requiring the labor union to distribute royalties to class members. Following the court's approval of the settlement, which included an enhancement award payment and class counsel fees, the insurer refused to cover the award, asserting: 1) the labor union's own arguments established the award does not arise from a "covered" claim; 2) "coverage cannot be bootstrapped based solely on a claim for attorney's fees;" and 3) there is no coverage for a claim seeking unpaid benefits the union had contractually agreed to pay. The court ruled in the insurer's favor, as the labor union acknowledged it had a preexisting duty to distribute the royalties, thereby failing to establish the award arose from a "covered" claim under the policy. "If a contracting party fails to pay amounts due under a lawful contract and is sued for that failure to pay, it cannot then obtain a windfall by having its payments covered by an insurance policy covering only 'wrongful acts.'" *Screen Actors Guild Inc. v. Fed. Ins. Co., et al.*, 2013 U.S. Dist. LEXIS 100638 (C.D. Cal. 2013).

Guilty Plea in Criminal Case Triggers Fraud Exclusion in E&O Policy

This coverage case involved an insurer's denial of coverage, its attempt to rescind the policy based on the fraud exclusion and the relevant "carve out" for coverage of defense costs until a final adjudication established the applicability of the exclusion. The insurer issued an escrow agents' errors and omissions (E&O) policy to the insured, a title and escrow exchange. Unbeknownst to the insurer, the company's owner and manager fraudulently disbursed several million dollars in funds being held in escrow, which led to criminal convictions. Clients victimized by the owner's actions filed claims against the insured, along with claims by depositors affected by the fraudulent disbursements who alleged the insured was negligent and in breach of contract. The issue before the court here only related to claims by depositors alleging the insured's failure to return escrow funds under the escrow agreement constituted negligence. The depositors did not allege criminal acts by the owner, but rather only the negligence of the entity in failing to return escrow funds. The insurer asserted that the policy's criminal act exclusion broadly excluded coverage for any insured individual or entity if the claim arose as a result of an underlying criminal act, regardless of whether the individual or entity were actually involved in the crime. The insured contended that, because only the owner, and not the corporate entity, was convicted of a crime, only the owner's individual coverage could fall within the fraud exclusion. In rejecting the insured's arguments, the court held that "[a]lthough the cross-claim alleges negligence in the failure to return the escrow funds, which would be "otherwise covered" under the policy, the "allegations" of the criminal act have been determined in criminal court. The written plea agreement contains the factual basis which includes the claim alleged in the cross-claim, thereby establishing that the claim arose out of a criminal act, which happened to be committed by the principal" of the insured entity. As such, the insurer was absolved of responsibility for defense or indemnity coverage. *Max Spec. Ins. Co. v. A Clear Title and Escrow Exchange, LLC, et al.*, 2013 U.S. Dist. LEXIS 108864 (M.D. Fla. 2013).

The insurers asserted that the policy's criminal act exclusion broadly excluded coverage for any insured individual or entity if the claim arose as a result of the underlying criminal act ...

To Qualify as a Whistleblower under Dodd-Frank, Information Must be Submitted to SEC

This Fifth Circuit opinion addressed who qualifies as a "whistleblower" under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). While working as an executive, plaintiff became concerned that his company engaged in conduct in violation of the Foreign Corrupt Practices Act (FCPA). Plaintiff reported his concerns to his supervisor, and soon after, was terminated. He then filed a complaint alleging the company violated Dodd-Frank's whistleblower-protection provision by terminating him following his internal reports of possible FCPA violations. Dodd-Frank defines a "whistleblower" as "any individual who provides ... information relating to a violation of the securities laws to the Commission, in a manner established ... by the Commission." Plaintiff conceded that he was not a "whistleblower" as that term is defined by Dodd-Frank because he did not provide any information to the SEC. However, plaintiff cited both SEC regulations and district court opinions from Connecticut, Tennessee and New York to support his position that the whistleblower-protection provisions should be construed to protect individuals who make required or protected disclosures, even if they do not provide information to the SEC. The court rejected plaintiff's argument, reasoning that "the plain language of the Dodd-Frank whistleblower-protection provision creates a private cause of action only for individuals who provide information relating to a violation of the securities laws to the SEC. Because [Plaintiff] failed to do so, his whistle-blower-protection claim fails." This decision is contrary to that of other federal appellate courts, potentially requiring the U.S. Supreme Court to weigh in on the matter. *Asadi v. G.E. Energy (USA), L.L.C.*, 2013 U.S. App. LEXIS 14470 (5th Cir. 2013.)

SEC Filings	SEC Settlements
• The SEC filed fraud charges against Robert Gandy, former CIO of now-defunct **PGI Energy, Inc.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Gandy from serving as an officer or director of a public company. • The SEC filed fraud charges against **China Intelligent Lighting and Electronics, Inc.**; **NIVS IntelliMedia Technology Group, Inc.**; and their respective CEOs, Xuemei Li and her brother, Tianfu Li. The SEC is seeking disgorgement, prejudgment interest, penalties, and officer and director bars.	• The SEC settled fraud charges against **Fuqi International, Inc. (Fuqi)** and Yu Kwai Chong, chairman, former CEO, and president. Fuqi and Chong were ordered to pay civil penalties of $1 million and $150,000, respectively; and Chong was barred from serving as an officer or director of a public company for five years. • The SEC settled fraud charges against Subramanian Krishnan, former CFO of **Digi International, Inc.** Krishnan was ordered to pay a penalty of $60,000 and was barred from serving as an officer or director of a public company for a period of five years. • The SEC settled fraud charges against Marcellous McZeal, former chairman and CEO of now-defunct **PGI Energy, Inc.** McZeal was ordered to pay disgorgement plus prejudgment interest of $19,919.37, a civil penalty of $70,000, and was permanently barred from serving as an officer or director. • Final judgment was entered on fraud charges against Edward O'Connor, former director and executive officer of **Optionable, Inc.** O'Connor was ordered to pay disgorgement of $550,000, a civil penalty of $150,000, and was permanently barred from serving as an officer or director of a public company.

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According to a study released by Ponemon Institute, the average annual cost associated with cybercrime increased by 6 percent to $8.9 million in 2012, driven largely by denial of service, malicious insiders, and website attacks.

General News

Accountability of Independent Directors

Harvard Business School professors Francois Brochet and Suraj Srinivasan released their study on the accountability of independent directors who sit on boards of public companies. Specifically, the authors examined which outside directors shareholders seek to hold accountable for corporate financial fraud and the ways in which shareholders express their displeasure. *Accountability of Independent Directors—Evidence From Firms Subject to Securities Litigation* analyzed 921 securities lawsuits filed between 1996 and 2010 where companies were sued for violations of Section 10b-5 of the Securities Exchange Act of 1934 or Section 11 of the Securities Act of 1933. The study showed that of the 921 suits filed, approximately 11 percent of independent directors were named as defendants. The authors found "the likelihood of being named is higher for independent directors who have served on the audit committee (54 percent of named defendants), have sold shares during the class period (16 percent of named defendants) or have been on the board for the entire class period." The incidence of being named is also higher, the authors concluded, when the plaintiff is an institutional investor and the lawsuit alleges Section 11 violations. In addition to seeking to hold independent directors accountable through litigation, the authors indicate shareholders can also seek to hold outside directors accountable by voting against the directors' re-elections. Thus, the authors examined shareholder voting and director turnover at sued companies, and found independent directors named in a securities lawsuit have a 5.47 greater percentage of withheld votes than a matched sample of independent directors from companies that had not been sued. They also suggest accountability can be reflected in greater turnover for named outside directors. Lastly, the authors analyzed the outcome of litigation when independent directors are named, concluding such cases are less likely to be dismissed, settle more quickly and have higher settlement amounts. The authors acknowledged there have only been 13 cases since 1980 in which an independent director made a personal contribution to a settlement or paid for any of their legal expenses.

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Cyber Risk Among Top Concerns for Directors in 2013

A new report titled *Law in the Boardroom*, based on the collective research of Corporate Board Member and FTI Consulting, suggests corporate directors and general counsel expect cyber risk to be among their top concerns this year. According to a study released by Ponemon Institute, the average annual cost associated with cybercrime increased by 6 percent to $8.9 million in 2012, driven largely by denial of service, malicious insiders, and website attacks. While executive compensation and merger/acquisition preparedness continue to dominate as the largest areas of focus for directors, cyber risk is also expected to require considerable board attention this year. The report indicates less than a quarter of surveyed directors feel "very confident" in their company's ability to detect and respond to a cyber breach, although directors seem to agree that IT strategy is a key area requiring more information and greater attention. According to Michael Pace, senior managing director of FTI Consulting's Global Risk and Investigations Practice, "the level of concern among board members and general counsel on data protection and security reflected in the survey is fully consistent with our recent work with multinational corporations ... we've seen a significant increase in our investigative work for companies that are faced with everything from hacking and intrusions to obtaining sensitive personal or proprietary information to foreign nationals who may be funneling trade secrets and other IP to foreign competitors or governments – classic economic espionage." Pace admits "[b]oard level concern is complicated by the fact that IT infrastructure and underlying technologies are fairly opaque to board members and certain executives," therefore one role of consulting firms such as FTI is to "demystify technology in addition to core investigative, remediation, and prevention work." As companies consider how to properly anticipate, detect, and respond to cyber risk, they should analyze the nature and level of risk particular to their industry and have policies, procedures, and infrastructure in place to ensure adequate protection.

Cases of Interest

Court Refuses to Interpret Specific Litigation Exclusion Broadly

This coverage dispute involved the application of a specific litigation exclusion contained in a directors and officers (D&O) policy. At the time the policy in question was issued, litigation remained ongoing against the insured and, as a result, the specific litigation exclusion was included to ensure coverage would not be available for the pending litigation. The pending litigation alleged the insured violated various state and federal laws relating to unfair competition, tortious interference with contractual relations, trade secret misappropriation and misrepresenting the nature, quality and characteristics of its products. After the D&O policy was issued, another lawsuit was filed against the insured alleging it engaged in a scheme to market and sell its products at inflated prices by advertising fictitious health benefits. The insurer relied on the specific litigation exclusion to deny coverage, but provided a defense under a reservation of rights. While agreeing that both suits alleged claims for unfair competition, the insured argued the most significant allegations in the initial lawsuit were not present in the subsequent suit. The insured further argued the carrier misrepresented the scope of the specific litigation exclusion in discussions prior to the issuance of the policy, promising coverage would exist for claims involving the insured's general business practices, and the specific litigation exclusion was limited to the pending case. Based on the record before the court, it determined factual disputes remained to be decided which prevented judgment from being entered for the insurer. The insurer "asks this court to read the language of the Policy as broadly as possible to exclude coverage. However, under the law, this court must construe the language exactly the opposite." Thus, in allowing the insured's claims to survive dismissal, the court reiterated the general principles that exclusions must be narrowly construed, and for a carrier to properly invoke an exclusion, its interpretation must be the only reasonable one. *Allied World Nat. Assurance Co. v. Monavie, Inc.*, 2013 U.S. Dist. LEXIS 97720 (D. Ut. 2013).

Private Equity Funds Potentially Liable for Pension Obligations of Portfolio Companies

... the appellate court found the funds' substantial involvement and control over the portfolio company rendered it more than a passive investor and supported the conclusion that the funds qualified as a "trade or business" for purposes of ERISA.

In a groundbreaking decision, the First Circuit Court of Appeals held a private equity fund can be liable for pension fund obligations of a portfolio company under its control. Specifically, where a private equity fund and its general partner or manager are significantly involved in the operation and management of a portfolio company, or realize benefits beyond that of a passive investor, the fund itself may be subject to the portfolio company's Employee Retirement Income Security Act (ERISA) obligations. Under Title IV of ERISA, to impose liability on a private equity fund, two conditions must be met. First, the fund must constitute a trade or business, and second, the fund must be under common control with the portfolio company. If these conditions are met, the fund is considered within the portfolio company's "controlled group," rendering it liable for the portfolio company's ERISA liabilities. In this case, following the bankruptcy of a portfolio company, a multiemployer pension plan sought to hold the private equity funds responsible for the portfolio company's withdrawal liabilities under ERISA. The funds did not have offices or employees, did not make or sell goods, and the only income reported by the funds came from investment income. However, numerous individuals with various affiliations to the funds exerted substantial operational and managerial control over the portfolio company prior to its bankruptcy. In overturning the trial court's judgment in favor of the private equity funds, the appellate court found the funds' substantial involvement and control over the portfolio company rendered it more than a passive investor and supported the conclusion that the funds qualified as a "trade or business" for purposes of ERISA. The question of whether the fund and portfolio company were under "common control" was sent back to the trial court because it failed to answer this question prior to the appeal. If common

control is found to exist between the private equity funds and the portfolio company on remand, this decision is likely to have widespread consequences for private equity funds and the venture capital industry as a whole. *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 2013 U.S. App. LEXIS 15190 (1st Cir. 2013).

Denial of E&O Claim Proper When Allegations Do Not Involve Covered Services

This coverage dispute involved an errors and omissions (E&O) policy issued to an insurance agency which sought coverage for claims asserted against it related to a real estate development deal. The underlying lawsuit alleged the insured was complicit in a scheme to sell membership interests in a project where they knew the appraisal and loans exceeded the value of the property without ever disclosing as much to potential investors. The insured tendered the underlying lawsuit for defense and indemnity coverage, both of which were denied. Coverage under the E&O policy was limited to "Covered Products," which the policy defined to include property and casualty insurance, life insurance, accident and health insurance, disability income insurance or fixed annuities, group employee benefit plans or disability plans, and group or ordinary pension or profit sharing plans. Additional covered products added by endorsement brought securities sold or serviced by the insured within the E&O policy's coverage. In upholding the denial of coverage and rejecting the insured's argument that the investment opportunity/development was a "security," the court found the nature of the underlying case to be grounded in fraudulent tort claims related to the purchase of real estate, which were outside the covered products specifically identified in the policy. "Because the allegations in the underlying state litigation concern a real estate transaction involving an inflated purchase price ... the disputed transaction cannot be found to be a Covered Product under the policy." *Am. Auto. Ins. Co. v. Smith*, 2013 U.S. Dist. LEXIS 91763 (S.D.W.V. 2013).

Portfolio Company's D&O Policy Does Not Cover Individual Acting in 'Capacity' as Manager of Private Equity Firm

This coverage case involved a private equity manager's request for coverage under a portfolio company's D&O policy. The manager, who was also an officer of the portfolio company, sought coverage for allegations against him for breach of an oral agreement he made to an individual to purchase portfolio company stock. The issue was whether the manager entered into the contractual agreement in his capacity as an employee of the portfolio company, in which case he would therefore be covered, or on behalf of the private equity firm. The court found in favor of the carrier, strictly construing the intent of the policy language that the insured must have committed a "Wrongful Act – error, misstatement, misleading statement, act, omission, neglect, or breach of duty committed by an Insured Person in their capacity as such ... or matter claimed against an Insured Person, solely by reason of their serving in such capacity." It was critical to the court that the complaint did not name the portfolio company, and only named the manager individually. Additionally, the court was not convinced that a subsequent letter of intent executed by the manager on behalf of the portfolio company regarding the purchase of the individual's companies' business and assets in exchange for portfolio company stock was extrinsic evidence of "capacity." The complaint focused solely on the oral agreement without referencing the letter of intent. For the court, it was "perfectly clear that [the manager] negotiated the alleged oral contact for the purchase of the shares on the side and on behalf of the [private equity firm] entities." *Britt v. Twin City Fire Ins. Co.*, 2013 U.S. Dist. LEXIS 135183 (C.D. Ca. 2013).

E&O Coverage Unavailable for Title Agency with Prior Knowledge of Claim

This coverage dispute arose following the denial of coverage for numerous lawsuits filed against an insured title company, which served as closing agent, issued title commitments, disbursed construction funds and sold title insurance policies in conjunction with real estate transactions. The lawsuits alleged various errors and omissions in the work performed by the title agency, which resulted in over $1.5 million in claims being paid by the underwriter of the title insurance policies. The title insurer then sought indemnification from the insured, who tendered the matters to its E&O insurer, and which prompted this lawsuit. In upholding the insurer's denial of coverage, the court relied on the prior-knowledge exclusion and the lien waiver exclusion contained in the policy as independent reasons that barred coverage. First, the court found the insured was aware of claims regarding title defects and payments made under title insurance policies sold by the insured prior to the time the E&O policy was in effect and, as such, the insured was under a duty to disclose the same in the policy application. Second, an explicit exclusion for claims arising out of the failure to obtain lien waivers for construction funds disbursed to contractors also precluded coverage for certain indemnification claims. *Lexington Ins. Co. v. Integrity Land Title Co.*, 2013 U.S. App. LEXIS 15621 (8th Cir. 2013).

Court Finds in Favor of Insurer on Extrinsic Evidence and Interrelated Wrongful Acts Language in D&O Policy

A federal court recently held an insurer may use extrinsic evidence to deny a duty to defend, so long as the insurer does not use that evidence to challenge the merits of the underlying litigation. Here, the company sought to compel the insurer to defend it against SEC subpoenas and a subsequent enforcement action because the claims were made during the insurer's policy period. The D&O insurer argued the subpoenas and enforcement action (which also included the company and an individual insured) were part of a single ongoing claim first made before its policy period began and related to a prior subpoena served on the company requesting documents. The insurer requested that it proceed with discovery to prove the interrelated nature of the prior subpoena, the current subpoenas, and the enforcement action. The company countered that the insurer could not rely on extrinsic evidence to determine the duty to defend; instead the insurer's duty to defend must be decided solely by reference to the underlying complaint and the policy. The court disagreed, finding an insurer "may use extrinsic evidence to deny a duty to defend based on facts irrelevant to the merits of the underlying litigation, such as whether the claim was first made during the policy period, whether the insured party reported the claim to the insurer as required by the policy, or whether the underlying wrongful acts were related to prior wrongful acts." The insured further argued that because the SEC enforcement action alleged wrongful acts that took place after the initial subpoena was served, the enforcement action could not be related to the wrongful acts underlying the subpoena. The court looked to the unambiguous definition of "Interrelated Wrongful Acts," and found the question is not whether the initial subpoena sought information about the later alleged wrongful acts, but whether there is a "common nexus" between the subpoena and the SEC enforcement action. On this point, the court noted additional discovery should shed further light on whether any written demands were made by the SEC to the individual which would be relevant to the scope of the insurer's duty to defend. Finally, the court found Massachusetts law does not require an insurer to defend while coverage issues are pending. If the insurer fails to defend, "the insurer simply risks liability for the defense costs that the insured party incurs (which may be higher than if the insurer had provided a defense)." *Biochemics, Inc. v. Axis Reinsurance Co.*, 2013 U.S. Dist. LEXIS 111218 (D. Mass. 2013).

The court ... found the question is not whether the initial subpoena sought information about the later alleged wrongful acts, but whether there is a "common nexus" between the subpoena and the SEC enforcement action.

Trustee Has Standing to Sue Carriers

After the insured filed for bankruptcy, the insured's liquidating trust made a claim against certain directors and officers for alleged improprieties which occurred two weeks prior to the insured filing for bankruptcy. The insured's D&O carriers denied coverage for the claim made by the trust, and the trust subsequently filed a lawsuit against the carriers. The first issue addressed by the court was whether the trust had standing to sue the carriers. The carriers pointed to the relevant state law, which prohibited an injured party from maintaining a direct action against the defendant's carriers, and argued the trust's "true interest in [the action] is as a purported holder of a claim against the [d]irectors and [o]fficers." The court held the trust had standing to file this action since it alleged: 1) an injury in fact (denial of insurance coverage); 2) a connection between the injury and the carriers' conduct (breaches of contact and good faith); and 3) likelihood the injury will be corrected by a favorable decision (if coverage is found to apply). The next issue was whether, as the carriers argued, the $50 million retention must be applied before proceeding with the claims alleged by the trust against the carriers. The carriers argued the insured's completed bankruptcy reorganization did not permit the trustee to obtain indemnification coverage until the retention was exhausted. The court held the trust can go forward with its complaint against the carriers relying upon the following factors: 1) the claim against the individuals sought $500 million; 2) available coverage under all policies was $250 million; 3) the $50 million retention did not apply to advancement of legal fees, and indemnification in the event of financial insolvency; and 4) the bankruptcy filing satisfied the requirement of "event of financial insolvency." *WMI Liquidating Trust v. XL Spec. Ins. Co.*, 2013 Del. Super. LEXIS 321 (Del. Super. Ct. 2013).

... the trust's "true interest in [the action] is as a purported holder of a claim against the [d]irectors and [o]fficers.

No Coverage for Claim Made within Policy Period and Reported During Automatic Extended Reporting Period

An insurer issued a claims made and reported professional liability policy to an insured in the real estate investment and lending industry. The policy included a 60-day "Automatic Extended Reporting Period" (AERP) upon non-renewal of the policy. During the policy period, the insured was named in a lawsuit concerning a failed real estate development and did not notify the insurer until the AERP went into effect. The insurer denied coverage and litigation ensued. The insuring agreement of the policy indicated the "[insurer] shall pay ... Loss resulting from any Claim ... first made against ... and reported to [Insurer] in writing during the policy period or any applicable Extended Reported Period for any Wrongful Act." The policy's claims reporting provision provided: "As a condition precedent to coverage under this Policy, [insured] shall provide [insurer] written notice of any Claim ... made against any Insured as soon as practicable after the [insured] becomes aware of such Claim ..., but in no event later than: 1) the expiration date of this Policy; 2) the expiration date of the [AERP] ..." Finally, the policy's AERP states: "If the [Insurer] or the [Insured] shall cancel or refuse to renew this Policy, then the [Insurer] shall provide the [Insured] an automatic and noncancellable extension of this Policy, subject otherwise to its terms, Limits of Liability, exclusions and conditions, to apply to Claims first made against the Insured during the sixty (60) days immediately following the effective date of such nonrenewal or cancellation, for any Wrongful Act committed before the effective date of such nonrenewal or cancellation and after the Retroactive Date (if any) and otherwise covered by this insurance. This [AERP] shall terminate after sixty (60) days from the effective date of such nonrenewal or cancellation." The federal trial court analyzed the policy and concluded "[t]he specific terms of the AERP only 'apply to claims first made against the Insured during the sixty (60) days immediately following the effective date of [the Policy's] nonrenewal or cancellation, for any Wrongful Act committed before the effective date of such nonrenewal or cancellation ... and otherwise covered by this insurance." The court noted the AERP's purpose is "to provide coverage when a wrongful act occurs during the policy period but the claim based on that wrongful act only materializes in the sixty days after the policy

... claims made and reported policies ... "allow insurers to 'close their books' on a policy by a date certain, and thus be able to price policies more accurately."

period, provided that the claim is reported within those sixty days." Because the claim wasn't first made within the AERP, the court concluded it did not apply. Instead, the claim was "first made" during the policy period and not reported in a timely manner. The court also repeated the long-standing reasoning in California that the notice-prejudice rule does not apply to claims made and reported policies because these types of policies "allow insurers to 'close their books' on a policy by a date certain, and thus be able to price policies more accurately." *PCCP LLC v. Endurance Am. Spec, Ins. Co.* 2013 U.S. Dist. LEXIS 114400 (N.D. Cal. 2013).

Pollution Exclusion Applicable in D&O Claim

This case involved a coverage dispute over the application of a pollution exclusion in a D&O policy. A local Michigan prosecutor's office filed criminal charges against an insured, a steel treating company, and one of its vice presidents for alleged violations of an Air Use Permit issued by Michigan Department of Natural Resources and Environment in connection with the company's operation of certain equipment. The insured submitted the criminal complaint to its insurer seeking defense and indemnity coverage. The insurer denied the claim based on the policy's pollution exclusion, which precluded coverage for a claim "arising from, based upon, or attributable to any a) discharge, dispersal, release, escape, seepage, migration or disposal of Pollutants ... or any threat of such discharge, dispersal, release, escape, seepage, migration or disposal;" or "b) direction, request or voluntary decision to test for, abate, monitor, clean up, treat, detoxify or neutralize Pollutants ..." The insured disputed the application of the exclusion on the grounds that the violations they were cited for involved allegations of failure to disclose and did not relate to any discharge or release of air pollutants. The court found in favor of the insurer, stating the "[d]efendants' arguments would be effective if the criminal charges related only to the release of pollutants. However, the criminal charges include violations of the [d]efendants" Air Use Permit..., which directed [d]efendants to abate pollutants" and thus the exclusion applies. *Arch Ins. Co. v. Commercial Steel Treating Corp. et al.*, 2013 U.S. Dist. LEXIS 12157 (E.D. Mich. 2013).

Contract and Fraud Exclusions Found Inapplicable to Intentional Misrepresentation Verdict

This coverage dispute addressed the applicability of contract and fraud exclusions in a D&O policy for a verdict rendered against an insured for intentional misrepresentation. The underlying matter alleged the insured's VP and Chief Technology Officer made material misrepresentations during the negotiation and execution of an Asset Purchase Agreement (APA). The contract exclusion in the D&O policy excluded coverage for any claim arising from liability under a contract, unless liability would attach absent the existence of the contract. The carrier argued the intentional misrepresentation claim arose from the APA since the insured, through its VP, made intentional misrepresentations that induced the underlying plaintiff to enter into the APA, and those misrepresentations were ultimately contained in the APA. The insured countered with evidence of conduct that occurred months before the parties executed the APA, arguing the insured would have been liable even if the APA was never executed. The court found in favor of the insured with respect to the contract exclusion, reasoning that because some of the conduct occurred before the APA was created, the claim did not arise from the insured's liability under the APA, and further, the carve-out to the exclusion applied. The court also found the fraud exclusion inapplicable because it only barred coverage for liability "based upon, arising from, or in consequence of any deliberate fraudulent act or omission ... by such Insured, if a final and non-appealable judgment ... adverse to such Insured established such a deliberately fraudulent act or omission." The court reasoned that "by using the term 'such Insured,' the fraud exclusion is focused upon deliberate fraud committed by the particular Insured that is seeking coverage, in this case, the [insured entity]." However, as a corporation, the insured did not commit deliberate fraud on its own, and therefore, the court examined which employees' conduct could be imputed to the entity. Per the "Severability of

Exclusions" clause, only the deliberately fraudulent acts of the insured's president, chairperson, CFO, or CEO were imputed to the entity. Because the underlying complaint alleged the misrepresentations were committed by a VP and Chief Technology Officer, the facts pertaining to, and the knowledge held by, these employees could not be imputed to the insured. *Transched Sys. v. Fed. Ins. Co.*, 2013 U.S. Dist. LEXIS 108736 (D.R.I. 2013).

Overdraft Fees Not Covered Based on Fee Exclusion

An insured bank was sued by a class of its customers that claimed overdraft fees charged were usurious interest charges in violation of Georgia law. The insured notified its professional liability carrier, which provided a defense, but refused to indemnify any judgment or settlement. The carrier claimed there was no coverage since: 1) the decision to charge an overdraft fee was a "deliberate business decision" and not a "Wrongful Act" as defined by the policy; 2) there were no allegations constituting "Professional Services;" 3) the amounts paid to settle the case were restitution and thus uninsurable; and 4) the policy contained an exclusion for "disputes involving fees, commissions or other charges for any Professional Service" or that portion of a settlement equal to such amount. The court easily dismissed the first two arguments, stating a "Wrongful Act" was broadly defined and the insured's charge of the fee amounted to an "act" that caused a "Loss." Second, the plain meaning of "Professional Services" was broad enough to include the practice of covering overdrafts for a fee as a service rendered for a customer or client in return for a fee. However, the court found the third and fourth arguments compelling. The court noted case law in various states suggesting "one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired." The court then held the fee exclusion contained in the policy was on point, in that the amounts paid in settlement represented a resolution of a dispute regarding fees charged. Thus, there was no coverage for the settlement based on the fee exclusion contained in the policy. *Fidelity Bank v. Chartis Spec. Ins. Co.*, 2013 U.S. Dist. LEXIS 110935 (N.D. Ga. 2013).

IvI Exclusion Bars Coverage for FDIC's Suit against a Failed Bank's Directors and Officers

This coverage dispute arose out of a fairly typical situation involving a failed bank taken over by the FDIC which then filed suit alleging one bank officer improperly approved loans and another fell short in his efforts to supervise. The D&O policy contained an exclusion that precluded coverage for claims "brought or maintained by or on behalf of any Insured ... in any capacity," with specified exceptions. The court held the policy's "Insured versus Insured" (IvI) exclusion barred coverage for the FDIC's suit, concluding that when the FDIC took over, it stepped into the shoes of the failed bank and became an "insured" for purposes of the exclusion. The court noted it would have to disregard the exclusion's use of the phrase "on behalf of," which in almost any imaginable situation would only apply to an FDIC suit on behalf of the bank. In other words, "[i]f the bank had sued [its two officers], the [IvI] exclusion would have applied to absolve the [insurer] from a duty to provide coverage to the [officers]. As such, the exclusion applies equally to the FDIC." The court rejected the FDIC's opposing arguments and concluded other courts had interpreted IvI exclusions with distinguishable policy language. Significantly, the court noted the FDIC's arguments were premised on the assumed "purpose" of the exclusion and the FDIC could not defeat the unambiguous policy language. Moreover, the FDIC's contentions were focused on several public policy arguments that did not justify modifying a private contract. Accordingly, the court upheld the IvI exclusion, which precluded coverage for the FDIC's suit against the failed bank's former directors and officers. *St. Paul Mercury Ins. Co. v. Miller* 2013 U.S. Dist. LEXIS 116877 (N.D. Ga. 2013).

... when the FDIC took over, it stepped into the shoes of the failed bank and became an "insured" for purposes of the exclusion.

SEC Filings	SEC Settlements
• The SEC filed fraud charges against Robert Gandy, former CIO of now-defunct **PGI Energy, Inc.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Gandy from serving as an officer or director of a public company. • The SEC filed fraud charges against John G. Rizzo, former CEO of **iTrackr Systems Inc.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Rizzo from serving as an officer or director of a public company. • The SEC filed fraud charges against several CEOs and their companies, including defendants Thomas Gaffney, **Health Sciences Group, Inc.**, Mark Balbirer, Stephen F. Molinari, and **Nationwide Pharmassist Corp.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Schultz, Martin, Gaffney, and Molinari from serving as officers or directors of a public company.	• The SEC settled fraud charges against **Anchor Bancorp Wisconsin, Inc.** and Dale C. Ringgenberg, former CFO. Ringgenberg was ordered to pay a penalty of $75,000 and was barred from serving as an officer or director of a public company for a period of five years. • Final judgment was entered against Conrad M. Black, former chairman and CEO of **Hollinger International, Inc.** Black was ordered to pay disgorgement of $2,546,586.99, prejudgment interest of $1,547,557.37, and was barred from acting as an officer or director of any public company. • The SEC settled fraud charges against Ebrahim Shabudin, former COO of **UCBH Holdings**, Inc. Shabudin was ordered to pay a penalty of $175,000 and was barred from acting as an officer or director of a public company. • Final judgment was entered against Jonathan C. Gilchrist, president and chairman of **Mortgage Xpress, Inc.** (subsequently renamed **The Alternative Energy Technology Center, Inc.**). Gilchrist was ordered to pay $842,493.40 in disgorgement and prejudgment interest, and was barred from serving as an officer or director of any public company.

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In a divided 3-2 vote, the Securities and Exchange Commission (SEC) adopted proposed rules requiring certain publicly-held companies to disclose the median annual total compensation of all employees, as well as the ratio of that median to the annual total compensation of the company's chief executive officer (the Pay Ratio Disclosure).

General News

Report Indicates General Counsel Desire a Seat at the Boardroom Table

In the *General Counsel Excellence Report*, which surveyed 270 chief legal officers globally, it was found that one in five general counsel surveyed aspired to sit on the board of directors of a company, either their own, or others. In addition, "most general counsel believe that having a lawyer sit on a company's board of directors improves corporate governance and encourages less corporate risk-taking." Somewhat unsurprisingly, the survey concluded that GC's leadership roles often increased during corporate emergencies and in assisting with crisis management planning. 60 percent of those surveyed reported working with their company's communications department all the time, while the figure jumped to 83 percent for strategic communications during a crisis. Additional findings noted in the report reveal that outside counsel are making better efforts to understand business needs and communicate better; however, law firms were found to still be lax in offering better fee deals, supplying more outsourcing options and/or the use of technology to reduce costs and improve services. Regulation and compliance were found to be the number one concern of GCs, followed closely by creating value for the company. Other top worries included anti-bribery and corruption, reorganization of legal departments, managing legal costs, data protection/security and cyber issues, reputational management, governance and dealing with emerging markets.

SEC Proposes Rules for Pay Ratio Disclosure

In a divided 3-2 vote, the Securities and Exchange Commission (SEC) adopted proposed rules requiring certain publicly-held companies to disclose the median annual total compensation of all employees, as well as the ratio of that median to the annual total compensation of the company's chief executive officer (the Pay Ratio Disclosure). The proposed rules were implemented in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). A few highlights include: Pay Ratio Disclosure requirements only apply to publicly-held companies required to provide summary compensation table disclosures pursuant to Item 402(c) of Regulation S-K, and not to emerging growth companies, smaller reporting companies, or foreign private issuers, and; companies must comply with the Pay Ratio Disclosure with respect to compensation for the company's first fiscal year commencing on or after the effective date of the final rules. With respect to the mechanics behind the Pay Ratio Disclosure, the proposed rules allow a company to identify the median annual total compensation of all employees by using their full employee population or by using a statistical sampling of employees or another reasonable method. An "employee" includes any full-time, part-time, seasonal or temporary worker employed by the company or any of its subsidiaries on the last day of the company's fiscal year, including non-U.S. employees. Finally, the proposed rules are not yet effective, and the SEC has solicited public comments in numerous areas in order to aid in the process of adopting final regulations. Of note, in March 2013, a bill was introduced in the House of Representatives which, if enacted, would entirely repeal the Pay Ratio Disclosure requirement. The House Committee supported the bill in June 2013.

Cases of Interest

Refusal of Derivative Demand Found Improper and Contrary to Evidence

In this shareholder derivative suit filed against an insured's board of directors, a federal district court held the board's rationale for refusing the demand was contradicted by the evidence, and permitted the case to move forward. The shareholder plaintiffs alleged that board members allowed certain Canadian pharmacies to advertise via the insured's search engine for the sale of prescription medication to be imported to the U.S. in violation of federal law. They further alleged the insured's employees were aware that Canadian online pharmacies were circumventing certification processes and did nothing to block the ads until 2009, when the insured became aware of a Department of Justice (DOJ) investigation into the matter. The insured ultimately entered into a non-prosecution agreement (NPA), which admitted wrongdoing and paid a $500 million fine to the U.S. government. Prior to initiating suit, plaintiffs made a demand upon the board to investigate and hold senior executives and directors responsible for the alleged violations of federal law. A committee created by the board refused the demand and cited a 149-page report as the basis of its conclusion. The report itself was never disclosed and the refusal is what brought about this litigation. In refusing to dismiss the case, the court noted the board's refusal was evaluated under "traditional business judgment rule standards," meaning the only issues for the court to decide were the good faith and reasonableness of the investigation into the claims articulated in the demand. While conceding the failure to make the report public did not, by itself, make the refusal unreasonable, when combined with the conclusory nature of the demand refusal letter (DRL), the court found the defendants effectively insulated the investigation from any scrutiny. "Moreover, the DRL's sweeping conclusion that no wrongdoing or culpability occurred, when coupled with the NPA's express acceptance of responsibility, does create reasonable doubt that the investigation was conducted reasonably and in good faith." As such, the case was permitted to move forward with the understanding that this decision did not opine on the actual merits of the board's decision to refuse plaintiff's demand, but based on the record, the court could not conclude the committee's investigation was undertaken reasonably and in good faith. *City of Orlando Police Pension Fund v. Page*, 2013 U.S. Dist. LEXIS 139904 (N.D. Ca. 2013).

In refusing to dismiss the case, the court noted the board's refusal was evaluated under "traditional business judgment rule standards," meaning the only issues for the court to decide were the good faith and reasonableness of the investigation into the claims articulated in the demand.

Denial Based on Notice Not Being Provided 'As Soon As Practicable' Upheld and New York's Notice-Prejudice Rule Found Inapplicable

This case addressed the notice provision under a "claims-made and reported" pollution liability policy requiring notice "as soon as practicable." The policy contained a New York choice-of-law provision and insured risks in California. The carrier denied coverage for three claims, two of which were noticed more than twelve months after the insured's receipt of such claims. The third claim was submitted to the carrier just two months after the insured received it. The court first held that the delay between receipt and notice for all three claims was unreasonable, and therefore, it was the insured's burden to justify the delay. The insured argued that policy language requiring claims be "made against the Insured during the policy period and reported to the Company during the policy period" rendered all notice of claims given within the policy period timely, regardless of whether such notice was given as soon as practicable after the claim was received by the insured. The court rejected this argument by differentiating between the requirement that a claim be reported within the policy period and the requirement that notice be afforded as soon as practicable. According to the court, the requirement that notice be provided as soon as practicable "protects the carrier against fraud or collusion; gives the carrier an opportunity to investigate claims while the evidence is fresh; allows the carrier to make an early estimate of potential exposure and establish adequate reserves and gives the carrier an opportunity to exercise early control of claims, which aids settlement," while the

reporting requirement provides the carrier with "greater certainty in computing premiums." Thus, "the reporting period has no bearing on the timeliness of notice of a claim." Relying on New York law, the insured then argued the carrier was required to show it was prejudiced as a result of the late notices. Under New York law, a carrier is required to show prejudice before a claim can be denied for late notice for policies "issued or delivered" in New York on or after January 17, 2009 (the "notice-prejudice" rule). The court held the notice-prejudice rule did not apply to the policy at issue in this case because it was not "issued or delivered" in New York. Thus, the insured "failed to comply with a condition precedent under the policy, that it provide notice 'as soon as practicable,' and is thus barred from recovery for its late claims." *Indian Harbor Ins. Co. v. City of San Diego*, 2013 U.S. Dist. LEXIS 137873 (S.D.N.Y. 2013).

Retailers 'Cyber' Policy Covers Consumer Protection Claims by Customers

This coverage dispute arose out of an insurer's denial of coverage under an internet liability policy issued to a retailer involved in multi-jurisdictional litigation alleging consumer protection violations. The underlying litigation alleged the retailer held a holiday gift card promotion offering $25 gift cards to consumers who purchased a certain amount of merchandise. The retailer imposed a void date on the gift cards, even though some of the cards had the words "no expiration date" and others had no printed information regarding their expiration. Consumers brought class-action complaints in three different states claiming similar consumer protection and breach of contract allegations. The operative endorsement in the internet liability policy stated the insurer "shall pay ... all damages and claim expenses ... arising out of the following: unfair competition, involving misuse of media communication, dilution, deceptive trade practices, civil actions for consumer fraud, false advertising or misrepresentation in advertising activities committed in the utterance, dissemination, gathering, acquisition, or obtaining of matter by your or with your permission solely in your performance of advertising." The insurer argued the endorsement was limited to claims arising out of "unfair competition" as that term was defined (i.e., "the misuse of a literary, artistic, audio-visual, musical, dramatic, or informational property right"). Because the consumer class actions did not allege "unfair competition," the insurer denied coverage. The court rejected the insurer's position. The holding turned on placement of a comma (before the word "involving") and the intent of the list of types of claims. The court looked at whether the term "unfair competition" was modified by all of the terms following the word "involving" (the insurer's interpretation) or only by the phrase "misuse of media communication" (insured's interpretation). The court found the insurer's narrow interpretation would render the endorsement nonsensical. The court said the language could have been more clearly written ("the comma before the word "involving" could have been omitted, or semicolons could have been used to separate each type of claim"); but it was not so unclear as to render it ambiguous. The court found the insured's interpretation more reasonable—the paragraph set forth separate legal claims, including unfair competition involving misuse of media communications, deceptive trade practices and civil actions for consumer fraud; all of which were alleged in the complaints against the insured. The court also looked at three additional coverage defenses raised by the insurer and sided against the insurer, finding that the title of the endorsement, "Privacy Breach and Privacy Regulation Breach Endorsement," did not limit or alter the unambiguous language and scope of the endorsement. Also, the contract exclusion did not preclude claims for consumer fraud as they were legally distinct from the breach of contract claims. Lastly, the court rejected the insurer's argument that the damages exclusion for "coupons, discounts, prizes ... or any other valuable consideration" applied; since the gift cards were given as a part of a promotion and were not "valuable consideration given in excess of the total contracted or expected amount." *ACE European Group, Ltd. v. Abercrombie & Fitch*, 2013 U.S. Dist. LEXIS 131269 (S.D. Ohio 2013).

The court said the language could have been more clearly written ... but it was not so unclear as to render it ambiguous.

Texas Court Finds No Duty to Defend under E&O Policy

In this case, a federal court ruled that a professional liability insurer did not have a duty to defend its insured since the claims in the underlying action fell outside the policy's definition of "Insured Services." The insured, a mortgage broker, was sued for the misuse of funds in an alleged investment scheme to purchase nonperforming residential mortgages for repackaging into performing loans. The coverage dispute centered around the meaning of "mortgage broker services," defined as "mortgage broker services ... consisting of counseling, taking of applications, obtaining verifications and appraisals, loan processing and origination services in accordance with lender and investor guidelines and communicating with the borrower and lender." The insurer argued the definition was an exhaustive list of covered services; whereas the insured, relying on a non-legal dictionary, claimed the definition represented an incomplete list of mortgage broker services. The court found the allegations in the underlying action were based on the insured's misuse of claimant's invested funds, not on mortgage broker services. The court went on to state that just because "the proposed investment scheme was supposed to involve mortgages does not overshadow the fact that the allegations ultimately stem from fraud and misappropriation of funds." *AXIS Surplus Ins. Co. v. Halo Asset Mgmt.*, LLC, 2013 U.S. Dist. LEXIS 139065 (N.D. Tex. 2013).

Contract Exclusion in D&O Policy Precludes Coverage for Defense Costs

The insured, a city development board, faced litigation from landowners who entered into option contracts with the insured to procure land for the potential site of a large manufacturing company. The carrier asserted it had no duty to defend based on the contract exclusion in the policy, which provided that it would not be liable "to make payment for Loss in connection with any Claim made ... arising out of or based upon any actual or alleged liability of the Insured Organization assumed or asserted under the terms, conditions or warranties of any contract or agreement." The insured disputed the applicability of the exclusion, arguing that no liability was "assumed or asserted" under the option contracts, the exclusion was ambiguous, the insured had a reasonable expectation of coverage, and public policy mandated that coverage be provided. The insured argued the plaintiffs in the underlying action were suing based on price guarantees contained in the contracts and not based on an assumption of liability from the contracts. However, the court found that liability was indeed asserted under the terms of the contract. Further, the exclusionary language was not ambiguous. The exclusion clearly contemplated claims arising out of or based on a breach of contract and because the terms of the exclusion were not ambiguous, the doctrine of reasonable expectations did not apply. Otherwise, the court would "be faced with the strong temptation to substitute its notion of equity ... and the doctrine could be used to invalidate every policy exclusion." Finally, the court found the terms of the contract did not violate public policy as this was a negotiated contract with unambiguous terms and the court would enforce it as written. Thus, the carrier had no obligation to defend the insured for the underlying claims. *Landmark Amer. Ins. Co. v. The Industrial Development Board of the City of Montgomery*, 2013 U.S. Dist. LEXIS 128041 (M.D. Ala. 2013).

... because the terms of the exclusion were not ambiguous, the doctrine of reasonable expectations did not apply.

Arizona Public Policy Does Not Prohibit Insurance Coverage for Restitutionary Damages

The dispute at issue emanated from a request for reimbursement under a D&O policy for a settlement paid by the directors and officers of a defunct entity from personal assets. The directors and officers settled the underlying class action for $16 million which had alleged the company violated Massachusetts' Tip Statute by failing to pay its employees the "service" charges it collected. The insurer refused reimbursement of the settlement, arguing it was uninsurable as a matter of public policy, which prompted the insureds to file suit against the insurer for breach of contract and bad faith. They also sued their insurance broker for

negligence, breach of contract and negligent misrepresentation, alleging the broker failed to procure insurance that covered the settlement and failed to advise of uninsured risks. The trial court found the settlement payment was restitutionary and therefore, uninsurable as a matter of public policy. While the court did not specifically address the insureds' claim for negligent misrepresentation against its broker, it entered judgment in favor of the broker on the insureds' claims of negligence and breach of contract. The insureds subsequently settled with the insurer and filed an appeal regarding the judgment in favor of the broker. One issue on appeal was whether the broker could have procured an insurance policy that would cover the insureds' settlement, which was restitutionary in nature. In order to answer the question, the Arizona appellate court was forced to determine whether payments constituting restitution were insurable under Arizona law or unenforceable as a matter of public policy. The court portrayed the issue as being whether Arizona law or public policy precluded insurance coverage for damages constituting restitution outweighed the interest in enforcing contractual agreements. In reversing the lower court and finding the settlement covered under the policy, the court noted: 1) Arizona public policy and case law did not prohibit insurance coverage for restitutionary payments; and 2) the lack of any legislation or judicial opinions on the issue weighed in favor of upholding private contractual agreements, regardless of their enforceability in other jurisdictions. *Cohen, et al. v. Lovitt & Touche, Inc.*, 2013 Ariz. App. LEXIS 191 (Az. App. 2013).

Notice of Circumstance Insufficient to Preserve Coverage and Claim Did Not Relate Back to Prior Policy Period

This coverage dispute involved whether a wrongful termination lawsuit filed after a policy was non-renewed was related to an alleged notice of circumstance and other claims made in a prior policy period. During the prior policy period, the insured sent a letter to the carrier stating that "[s]ince [the insurer] has chosen to [nonrenew] our account please let this serve as notice of an 'incident' or 'claim' to protect our rights under the policy. At this time no formal demands have been made against the company ..." Subsequently, the insured was placed in conservatorship, and an order was issued stating that the conservator "shall not be subject to any liability on the basis of a failure to defend [the plaintiff's wrongful termination lawsuit]." The insurer first argued based on this order that there was no "Loss" because "Loss" excluded "any amount for which an insured organization ... is absolved from payment by reason of any covenant, agreement ... or court order." The court disagreed, reasoning that the order does not absolve the insured from liability. Next the court addressed whether the letter from the insured providing notice of an "incident" or "claim" preserved coverage for future "Employment Claims." The relevant reporting provision stated that "[i]f during the Policy Period ... an Insured becomes aware of a Potential Employment Claim ... or becomes aware of circumstances which could give rise to any Claim other than an Employment Claim, and gives written notice ... then any Claim subsequently arising from such Potential Employment Claim ... or circumstances shall be considered to have been made against the Insured during the Policy Year in which the Potential Employment Claim ... or circumstances were first reported to [the Insurer]." The court held that the notice of circumstances was insufficient to preserve coverage, reasoning that the reporting provision limited "the use of notice 'of circumstances' to preserve coverage for a 'Claim, other than an Employment Claim.'" Finally, the court rejected the plaintiff's argument that the wrongful termination suit was related to lawsuits filed during the policy period, stating the plaintiff failed to provide any facts to support his argument. *Lemons v. Mikocem*, 2013 U.S. Dist. LEXIS 133976 (E.D. Mich. 2013).

... the reporting provision limited "the use of notice 'of circumstances' to preserve coverage for a 'Claim, other than an Employment Claim.'"

Letter Written to Defense Counsel Seeking Extracontractual Damages in Underlying Litigation Not a Claim under ICPL Policy

The court again stated that the injured party's letter was written to defense counsel, not the carrier; therefore, the letter did not meet the definition of a claim.

An insurance company professional liability policy (ICPL) afforded claims made and reported coverage for claims arising out of any act, error or omission in the insurance company's rendering of or failure to render services in connection with its business as an insurance company. The policy defined "claim" as "1. a written demand for monetary damages; or 2. a judicial, administrative, arbitration, or other alternative dispute proceeding in which monetary damages are sought." More than two years prior to the inception of the ICPL policy, an accident occurred. A policy limits demand was made and not accepted by the underlying insurer. The injury claim proceeded for more than two years. Two weeks before the inception of the ICPL policy, the injured party's counsel wrote to defense counsel to discuss a potential bad faith claim that could result in extracontractual damages. The letter notified defense counsel that the carrier would need to "open" its policy limits at the mediation if it was serious about settling the case. The injured party's lawyer recognized that defense counsel had no role in evaluating the bad faith claim. Defense counsel sent the letter to the carrier eight days before the ICPL policy incepted. The case did not settle at mediation and the carrier notified its ICPL insurer of a potential bad faith claim. A jury awarded the injured party $17 million, which eventually resulted in a $7 million settlement. The ICPL insurer denied coverage on the grounds that the bad faith claim was first made prior to the inception of the ICPL policy because the injured party's letter to defense counsel was "a written demand for monetary damages," and met the definition of "claim." The ICPL insurer contended using the terms "extracontractual amounts" and "opening" the policy limit meant the injured party's counsel sought to recover directly from the insured. To the contrary, the carrier argued that the letter at best was simply a notice of potential claim and not a "claim." The court concluded that "[w]hile the letter is in 'written' form, it is not addressed to [the carrier]. The letter is from [the injured party's] counsel to [defense] counsel. Because the letter was not addressed to [the carrier], it can hardly be considered a demand on the same. The express policy language covers wrongful acts by [the carrier], and therefore, requires that the written demand for damages be made upon the insured ... and not a third-party." The court also rejected the ICPL insurer's pre-inception argument because although a copy of the letter under Florida law was sent, the injured party could not assert a direct claim against the carrier before an actual verdict or settlement, which had not occurred when the letter was written. The ICPL insurer then argued the letter about the upcoming mediation met the ICPL policy's second definition of claim because mediation is "a judicial, administrative, arbitration, or other alternative dispute proceeding in which monetary damages are sought." Even though the mediation took place before the ICPL policy period, the court highlighted that "[a]t most, the letter constitutes notice of mediation, not the 'alternative dispute proceeding' itself as defined by the policy language." The court again stated that the injured party's letter was written to defense counsel, not the carrier; therefore, the letter did not meet the definition of a claim. *Lexington Ins. Co. v. Horace Mann Ins. Co.*, 2013 U.S. Dist. LEXIS 127544 (N.D. Ill. 2013).

SEC Filings

- The SEC filed fraud charges against **ChinaCast Education Corporation's (ChinaCast)** former CEO and chairman of the board, Chan Tze Ngon, and Jiang Xiangyuan, ChinaCast's former president for operations in China. The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Ngon and Xiangyuan from serving as directors or officers of a public company.
- The SEC filed fraud charges against **Imperial Petroleum** and Jeffrey Wilson, CEO. The SEC is seeking disgorgement, penalties, and an order barring Wilson from serving as an officer or director of a public company.
- The SEC filed fraud charges against **Imaging Diagnostic Systems**; Linda Grable, CEO; and Alan Schwartz, CFO. The SEC is seeking penalties and an order barring Grable and Schwartz from serving as directors or officers of a public company.
- The SEC filed insider trading charges against Jing Wang, former executive VP and president of global business operations at **Qualcomm**. The SEC is seeking disgorgement, prejudgment interest, penalties and an order barring Wang from serving as an officer or director of a public company.
- The SEC filed fraud charges against Troy Lyndon, founder, CEO, and CFO, of **Left Behind Games Inc.** The SEC is seeking penalties and an order barring Lyndon form serving as an officer or director of a public company.

SEC Settlements

- The SEC settled fraud charges against **ImageXpres** Corporation; John Zankowski, president and CEO; and Kevin Zankowski, CFO. John Zankowski and Kevin Zankowski were barred from acting as officers or directors of a public company and were ordered to pay penalties of $50,000 and $25,000, respectively.
- The SEC settled fraud charges against **Mercantile Bancorp (Mercantile)**; Ted Awerkamp, former CEO; and Michael McGrath, former CFO. Awerkamp and McGrath were ordered to pay penalties of $100,000 each and were barred from acting as officers or directors of a public company.
- The SEC settled fraud charges against **Universal Travel Group (UTG)**; its former CEO, Jiangping Jiang; and its former interim CFO, Jing Xie. UTG, Jiang and Xie were ordered to pay civil penalties of $750,000, $125,000 and $60,000, respectively; and Jiang and Xie were barred from serving as officers or directors of a public company for five years.
- The SEC settled fraud charges against Louis R. Tomasetta, former CEO and former director of **Vitesse Semiconductor Corporation**, and Eugene F. Hovanec, former VP of Finance, CFO, and Executive VP. Tomasetta was ordered to pay $2,126,450 in disgorgement, a $100,000 civil penalty, and was barred from serving as an officer or director of any public company for ten years. Hovanec was ordered to pay $781,280 in disgorgement, a $50,000 civil penalty, and was barred from serving as an officer or director of any public company for ten years.
- The SEC settled fraud charges against Owen Mark Williams, CFO of **True North Finance Corporation**. Williams was ordered to pay a $40,000 civil penalty.

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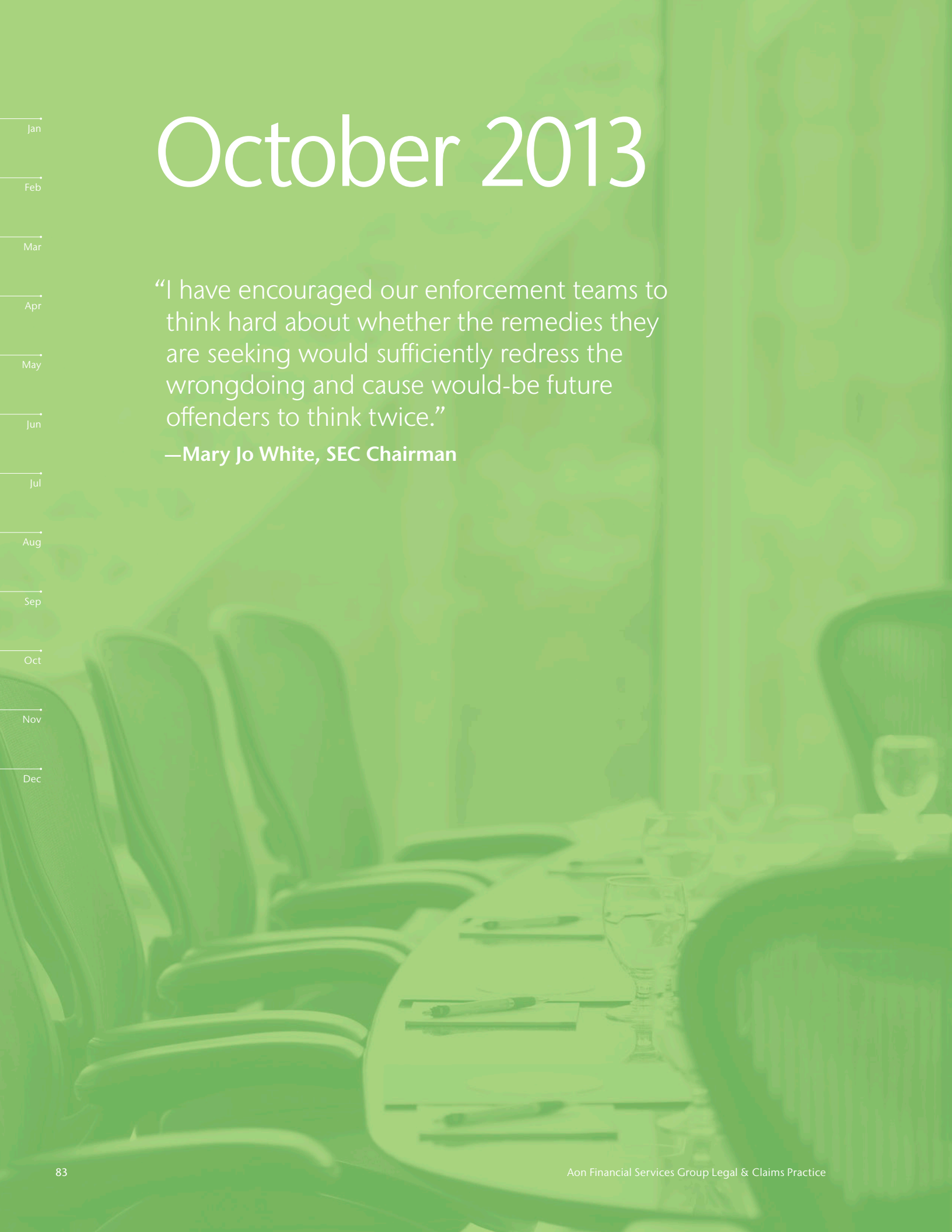
"I have encouraged our enforcement teams to think hard about whether the remedies they are seeking would sufficiently redress the wrongdoing and cause would-be future offenders to think twice."

—Mary Jo White, SEC Chairman



General News

SEC Gets Tough on Wall Street

Following her appointment earlier this year as the new Chairman of the Securities and Exchange Commission (SEC), former prosecutor Mary Jo White vowed to crack down on Wall Street and ramp up the agency's policing of financial fraud, a claim that has proven reliable over the past six months with the commission's new policies and initiatives. "We need to be certain our settlements have teeth and send a strong message of deterrence," Ms. White said. "That is why in each case I have encouraged our enforcement teams to think hard about whether the remedies they are seeking would sufficiently redress the wrongdoing and cause would-be future offenders to think twice." The SEC has made a number of public announcements airing its hardline enforcement priorities and has also begun to exercise new enforcement authority under the Dodd-Frank Act, particularly with respect to corporate accounting failures. Inferring that "[w]hen people fear for their own reputations, careers or pocketbooks, they tend to stay in line." The SEC has also reformed its use of "no admit, no deny" provisions in settlement agreements which historically permitted defendants to resolve charges without admitting to any legal violations or alleged conduct. Under its new policy, the SEC will determine on a "case-by-case" basis whether it will require individual defendants to admit liability. It is anticipated that most cases will continue to include "no admit, no deny" provisions, but the SEC will stray from this approach where there is "intentional conduct or widespread harm to investors," or when the defendants placed "the market at risk of potentially serious harm" or "engaged in unlawful obstruction of the commission's investigative processes." Advisory firm Harbinger Capital Partners and hedge fund adviser Phillip Falcone were the first defendants to provide admissions of wrongdoing following the implementation of the SEC's new policy, a settlement which included a payment in excess of $18 million and an admission to misconduct that interfered with the normal functioning of the securities markets. The SEC's aggressive new stance will inevitably lead to a flurry of new enforcement activity, therefore it is critical for boards of directors to consider the impact of such admissions on the accessibility of D&O insurance to cover defense costs and indemnity obligations. Several different provisions in D&O insurance policies may be implicated, including conduct exclusions, severability, and the potential for repayment of previously advanced defense costs. Since conduct exclusions are intended to exclude from coverage any claims involving deliberate fraudulent acts or illegal profit or advantage, carriers may argue admissions in an SEC settlement trigger the conduct exclusion and consequently bar coverage for defense costs in a SEC action, as well as defense costs and indemnity for future or simultaneous criminal and civil lawsuits arising out of the same set of facts. "Final adjudication" language may also prove useful in a SEC settlement if an agreement is reached in the context of an administrative proceeding, or if the conduct exclusion is triggered only when an admission occurs in the "underlying action" rather than the broader "any underlying claim" language in certain policies. On the issue of severability, companies should be aware of how their D&O policies will react as provisions related to the insurance application may be implicated even when admissions do not rise to the level of triggering the conduct exclusion. Well-drafted severability language should decrease the likelihood of a rescission argument by an insurer. The key takeaway is that while the SEC continues down its aggressive new path, policyholders should be particularly mindful of their policy provisions and the impact SEC settlement discussions may have on the availability of their D&O insurance.

The SEC's aggressive new stance will inevitably lead to a flurry of new enforcement activity, therefore it is critical for boards of directors to consider the impact of such admissions on the accessibility of D&O insurance to cover defense costs and indemnity obligations.

Global Trends in Board-Shareholder Engagement

In The Conference Board's Director Notes series, James Kim and Jason D. Schloetzer, address the increasing trend of shareholder requests for special meetings with board members along with potential benefits, complexities and developments in the use of technology to facilitate engagement. Studies indicate 87% of issuers, 70% of asset managers and 62% of asset owners reported at least one engagement in the previous year with the level of engagement increasing as well. Specifically, 50% of issuers, 64% of asset managers, and 53% of asset owners report they've been engaging more, while only 6% of issuers reported a decrease in engagement with shareholders. The authors note increased engagement parallels a wave of shareholder activism that emerged in the mid-2000s, and evidences shareholders' interest in gaining insight into how companies allocate resources to generate returns. Benefits noted from increased engagement include a reduced likelihood of shareholders being caught by surprise by corporate disclosures, the ability to provide shareholders with additional information on long-term strategies, and creating greater investor trust. Complexities that can result include the possibility that information shared may be inconsistent with other disclosures, can result in excessive demands for ad-hoc engagement by shareholders, or violations of Regulation FD if the information shared is not disseminated to all market participants. Concerns surrounding increased engagement include directors coming off poorly in shareholder meetings as a result of being unable to answer specific questions or appearing unprepared. The report goes on to discuss engagement in other countries along with examples of engagement by large U.S. companies and the perceived results from such meetings.

The Viability of 'Say on Pay' Derivative Lawsuits Questioned

A recent appellate court decision affirming the dismissal of a "say on pay" derivative lawsuit has some commentators believing this is the beginning of the end for such suits. Section 951 of the Dodd-Frank Act (Dodd-Frank) requires public companies to include in their proxy statements "a separate resolution subject to shareholder vote to approve the compensation of executives." The statute expressly states that the vote is only advisory, and that it "may not be construed ... to create or imply any change to the fiduciary duties of such issuer or board of directors ... [or] to create or imply any additional fiduciary duties of such issuer or board of directors." Despite this limiting language, shareholders have argued the "say on pay" provisions give them a right to "sue on pay," and have filed derivative lawsuits against the boards of many companies that lost a "say on pay" vote. A California court has now issued the first appellate decision affirming the dismissal of such a case. In *Charter Township of Clinton Police & Fire Retirement System v. Martin*, the court applied Delaware law and held that a pre-suit demand on the board was not excused. First, the plaintiffs failed to establish the directors were not disinterested and independent since the "mere threat of personal liability for approving a questioned transaction ... is insufficient to challenge the independence or disinterestedness of directors." The court further reasoned the plaintiffs failed to establish "the executive compensation plan was so ill conceived and irrational as to violate the business judgment rule." It was the general consensus that the "say on pay" provision allowed shareholders to express their views, and that a shareholder vote against a plan should not be the basis for a derivative lawsuit. With the consistent dismissal of these lawsuits, courts appear to properly recognize the purpose and scope of liability under discreet provisions in Dodd-Frank.

Despite this limiting language, shareholders have argued the "say on pay" provisions give them a right to "sue on pay," and have filed derivative lawsuits against the boards of many companies that lost a "say on pay" vote.

Cases of Interest

Insured Loses Bid to Send Securities Suit Abroad

The insured, a non-U.S. based entity, faced securities litigation arising from the loss in value of shares traded in London and the American Depositary Shares listed on the NYSE, allegedly due to misrepresentations involving the insured's U.S. operations. The insured moved to dismiss the case on multiple grounds, including that English law applied to certain claims, as well as the doctrine that a court may decline to exercise jurisdiction if the convenience of the parties and the interests of justice indicate the case should be tried elsewhere. This required the court to decide if there is an adequate alternate forum and evaluate private interest factors (such as witness availability and cost considerations) along with public interest factors, including court administrative burdens, local interests, familiarity with relevant law and conflict of laws issues. Here, the court determined that even if England was an available forum, the private and public interest factors did not indicate the U.S. court was an inconvenient forum for the English law claims. Due to the multi-district litigation pending in the U.S., it would be inefficient to send the case to England when nearly the same issues would be adjudicated in the U.S. Only one public interest factor weighed in favor of dismissal - the need to apply foreign law to certain claims. But, the U.S. court found itself more than capable of applying English law based on strong similarities to U.S. law due to their common heritage. Further, the controversy was unquestionably local, such that resolving it locally would not unduly burden the community. Finally, the alleged misrepresentations dealt with U.S. operations of the insured conducted by U.S. subsidiaries. The court determined that neither the private nor public interest factors weighed heavily in favor of dismissal. *In re BP P.L.C.*, 2013 U.S. Dist. LEXIS 142946 (S.D. Tex. 2013).

Only one public interest factor weighed in favor of dismissal - the need to apply foreign law to certain claims.

Dodd-Frank's Anti-Retaliation Provision Does Not Apply Extraterritorially

A whistleblower action brought by a non-U.S. citizen against a foreign corporation under the Anti-Retaliation Provision of the Dodd-Frank Act was dismissed, with the court holding the conduct in question not protected by the statute. A Taiwanese resident and regional compliance officer for a Chinese subsidiary of the defendant, a German corporation, sued the corporation accusing it of wrongfully terminating him for reporting possible Foreign Corrupt Practices Act (FCPA) violations. The judge found that the Anti-Retaliation Provision of the Dodd-Frank Act does not apply extraterritorially, and therefore, plaintiff did not qualify for its whistleblower protections, which prohibit retaliatory acts against a whistleblower, defined by the Act as "any individual who provides . . . information relating to a violation of the securities laws to the [SEC], in a manner established, by rule or regulation, by the [SEC]." The court noted that the Anti-Retaliation Provision is silent on whether it applies outside the U.S. and that "this silence invokes a strong presumption against extraterritoriality." The court cited to the Supreme Court decision in Morrison v. National Australia Bank, a case which held the Securities and Exchange Act of 1934 does not apply extraterritorially in support of its conclusion that if Congress had intended Dodd-Frank's whistleblower protections to extend to persons outside the U.S., it would have clearly expressed such an intent in the language of the statute. Given the absence of clear language that Congress intended the statute to have extraterritorial reach, the court held that the provision does not apply to overseas employees. The court highlighted that the "case is brought by a Taiwanese resident against a German corporation for acts concerning its Chinese subsidiary relating to alleged corruption in China and North Korea" and that the only connection to the U.S. is the fact that the corporation has ADRs that trade on the New York Stock Exchange. *Liu v. Siemens A.G.*, 2013 U.S. Dist. LEXIS 151005 (S.D.N.Y. 2013).

Reformation Request Denied But Obligations to Fund Defense Upheld

The E&O insurer argued the GL policy was intended to cover the entity as a named insured such that the policy should be reformed to that effect.

This coverage case involved a suit by an E&O insurer against a GL insurer with a mutual insured seeking reformation of the GL policy. The E&O insurer sought contribution from the GL insurer toward settlement and defense costs incurred in defending their mutual insured's underlying litigation. The underlying class action litigation alleged unlawful automated telephone calls under Washington's consumer protection law. The underlying litigation was noticed to several insurers in the insured's E&O and GL programs. Four insurers accepted coverage, agreed to defend, and eventually settled the matter. The settlement agreement detailed the contributions of each party, with defense costs split equally among the four insurers with duty to defend obligations. Under the terms of the settlement, all parties released one another for all claims except the two insurers involved in this coverage dispute, which focused on whether the GL policy intended to cover the named defendant in the underlying litigation when it did not specifically name the entity as an insured. The E&O insurer argued the GL policy was intended to cover the entity as a named insured such that the policy should be reformed to that effect. Reformation would require the GL insurer to contribute to the settlement. To obtain reformation, the E&O insurer had to show that the GL insurer and the insured had a mutual intent at the time the contract was executed which was not reflected in the insurance policy. The court found that neither party produced clear or dispositive evidence that the named entity was or was not intended to be a named insured on the GL policy; thus denying reformation. In the alternative, the E&O insurer argued that even absent reformation, the GL insurer had a duty to defend because it issued a reservation of rights letter accepting the defense. The court agreed on this point and found that Washington law was clear in the context of insurance law, and contribution allows an insurer to recover from another insurer where both are independently obligated to indemnify or defend the same loss. Here, the GL insurer had an independent obligation to defend the loss stemming from the underlying action due to their agreement to do so by way of the reservation of rights letter. Accordingly, the GL insurer was compelled to contribute its 25% contribution toward the defense costs. *AXIS Surplus Ins. Co. v. Hartford Accident & Indem. Co.* 2013 U.S. Dist. LEXIS (W.D. Wash 2013).

Known Circumstances Exclusion Barred Coverage under D&O Policy

In this case, a federal appellate court held a "Known Circumstances Exclusion" in a D&O policy precluded coverage for an underlying claim. The insured was a non-profit private school which was struggling financially. Parents donated money to the school on the condition they receive a security interest in the school's land and the funds be used to construct a new high school. Shortly after receiving the donation, money was paid to the family of the school's director "purportedly for repayment of loans." The donors filed suit against the school and the director for failing to satisfy the conditions of the donation and the case was ultimately settled with a portion of the gift returned to the donors. Upon receipt of the lawsuit, the school's D&O insurer denied coverage, claiming the costs associated with the suit were losses precluded by a manuscript exclusion which excluded losses "based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving any matter, fact or circumstance disclosed in connection with Note 8 of the Financial Statement," which specifically described the school's financial difficulties and the donation. The school argued the exclusion was intended only for losses resulting from the school's financial problems and was not intended to apply to the donation. The school's arguments also included the rules of contract construction, as well as the school's reasonable expectations of coverage. An insurance policy whose provisions are plainly expressed in appropriate language must be enforced in accordance with its terms. If a policy is ambiguous, any ambiguities must be construed in favor of the insured. However, when

an insurance contract is not ambiguous, a party can have no reasonable expectation of coverage when that expectation would run counter to the unambiguous language of the insurance policy. The court disagreed with the school's argument regarding the intent of the exclusion, asserting the exclusion was plain and unambiguous on its face. The court also rejected the school's argument that the exclusion was intended to only exclude losses arising out of the school's financial difficulties, and further concluded that the language could not be read as being limited to losses resulting from the school's financial difficulties. Finally, the court rejected the school's reasonable expectations argument and concluded that "[b]ecause the language of this policy clearly excludes coverage 'in any way involving' the [donor's] gift, the school had no reasonable expectation of coverage." *Clark School for Creative Learning, Inc. v. Philadelphia Indem. Ins. Co.*, 2013 U.S. App. LEXIS 21568 (1st Cir. 2013).

... when an insurance contract is not ambiguous, a party can have no reasonable expectation of coverage when that expectation would run counter to the unambiguous language of the insurance policy.

Denial of Coverage under Fidelity Bond Upheld Despite Broad Policy Language

In a case involving computer systems fraud coverage, the court upheld the denial of coverage for fraudulent claims presented to and paid by an insured. The insured, a health insurance company, sought to recover losses from fraudulent claims made by medical providers for alleged services provided to plan participants. The nature of the fraudulent claims varied from kickback schemes to patients or providers' information being used to bill for services which were either never provided or done without their knowledge, resulting in the payment of benefits ultimately deemed fraudulent. After coverage was denied under the computer systems fraud rider included in a financial institution bond, litigation ensued, requiring the court to determine the meaning of a clause in the rider that the insured shall be indemnified for "loss resulting directly from a fraudulent...entry of Electronic Data...into [the insureds] proprietary Computer System." The insured argued the clause covered the entry of fraudulent information, i.e. fraudulent claims, even by an authorized user of the computer system. The insurer countered that coverage was only provided for situations in which an unauthorized user accessed the system and caused money to be paid by the insured. The court found the clause at issue to be unambiguous and relied on the headings contained in the policy to reach its conclusion. According to the court, and despite the fact that the headings do not alter or amend the terms of coverage, it found the headings indicated coverage was directed at misuse or manipulation of the system itself, rather than situations where the fraud arose from the content of the claim through otherwise proper use of the computer system. On appeal, New York's highest court agreed with the trial court's decision without ever addressing the precise policy language at issue. *Universal Amer. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2013 N.Y. App. Div. LEXIS 6278 (N.Y. App. Div. 2013).

Carrier Not Liable for Bad Faith Failure to Settle Where There Was No Settlement Demand from Claimant

This case addressed whether a carrier was liable for bad faith failure to settle when liability was clear and there was a substantial likelihood of a recovery in excess of the policy limits, but there was no demand or settlement offer from the claimant. Soon after an insured was involved in an auto accident, an adjuster for the carrier called the claimant's insurer and stated that the carrier "was accepting liability and that there may be a limits issue." The claimant's son then asked the carrier if it could disclose the policy limits, and the carrier responded that it could not without the written permission from the at-fault driver. A few days later, the carrier wrote to the claimant saying that the carrier's investigation was incomplete and "therefore we are not in a position to resolve liability or settlement of this claim." The carrier subsequently wrote to the claimant's attorney agreeing to tender the policy limits. The attorney rejected the

offer, obtained a verdict in excess of the policy limits, and sued the carrier for bad faith failure to settle. The court held the carrier was not in bad faith, reasoning that "[a]n insurer's duty to settle is not precipitated solely by the likelihood of an excess judgment against the insured." "For bad faith liability to attach..., there must be some evidence either that the injured party has communicated to the insurer an interest in settlement, or some other circumstance demonstrating the insurer knew that settlement within the policy limits could feasibly be negotiated." In the absence of such evidence, there is no "opportunity to settle" that a carrier may be charged with ignoring. Here, there was no settlement offer from the claimant nor evidence that the carrier knew or should have known the claimant was interested in settlement. *Reid v. Mercury Ins. Co.*, 2013 Cal. App. LEXIS 798 (Cal. App. 2013).

Search and Seizure Warrant and Subpoena are Claims under D&O Policy

This D&O coverage dispute arose out of a search and seizure warrant accompanied by a subpoena from the National Aeronautic and Space Administration (NASA) Office of the Inspector General, and a letter from the U.S. Attorney indicating the insured was being investigated for civil liability concerning its participation in a federal program. The insured retained defense counsel to respond to the investigations and submitted the law firm's invoices to the insurer for reimbursement. The insurer declined to reimburse the insured's defense expenses because "the NASA subpoena and Search [and] Seizure Warrant [were] not demands for relief or proceedings commenced by the service of a complaint or similar document." The court applied Virginia law, which favors liberal policy construction, and determined the D&O policy covered the defense expenses associated with the search warrant and subpoena. Significantly, the court highlighted that the D&O policy broadly defined the term "Claim" to include any "written demand for monetary, non-monetary, or injunctive relief made against an Insured" and any "judicial, administrative, or regulatory proceeding, whether civil or criminal, for monetary, non-monetary or injunctive relief commenced against an in Insured... by (i) service of a complaint or similar pleading." To this end, the court concluded the NASA search warrant and the subpoena fell within the definition of "Claim" as written demands for non-monetary relief and as judicial proceedings commenced by service of a complaint or similar pleadings. The court highlighted that other courts had also established that subpoenas and search warrants were "claims" under similar policy language. Consequently, the insurer had a duty to defend the insured and reimburse it for defense expenses. *Prot. Strategies, Inc. v. Starr Indem. & Liab. Co.*, Civil Action No. 1:13-CV-00763 (E.D. Va. 2013).

... the NASA search warrant and the subpoena fell within the definition of "Claim" as written demands for non-monetary relief and as judicial proceedings commenced by service of a complaint or similar pleadings.

SEC Filings	SEC Settlements
• The SEC filed fraud charges against **Yuhe International**, Inc. and Gao Zhentao, CEO. The SEC is seeking penalties, disgorgement, prejudgment interest, and an order barring Zhentao from serving as an officer and director of a public company.	• The SEC settled fraud charges against **Petro-Suisse** and Mark Gasarch, director, treasurer and legal counsel. Petro-Suisse and Gasarch were ordered jointly and severally to pay $8,370,000 in disgorgement, and Gasarch was ordered to pay a $130,000 penalty. • The SEC settled fraud charges against Philip A. Falcone and his advisory firm, **Harbinger Capital Partners, LLC, Harbinger Capital Partners Offshore Manager, LLC, and Harbinger Capital Partners Special Situations Group, LLC**. Falcone was ordered to pay $6,507,574 in disgorgement, $1,013,140 in prejudgment interest, and a $4 million penalty. The Harbinger entities were ordered to pay a $6.5 million penalty. • The SEC settled fraud charges against **China MediaExpress Holdings, Inc.** and Zheng Cheng, chairman and CEO. China Media was ordered to pay disgorgement and prejudgment interest of $41,894,082.05 and a penalty of $7,250,000. • The court entered a default judgment in connection with fraud charges against Peter Madoff, former chief compliance officer and senior managing director at **Bernard L. Madoff Investment Securities LLC** from 1969 to 2008. The default judgment orders no monetary relief in light of Peter Madoff's criminal conviction and the $143 billion in restitution ordered in the parallel criminal proceeding *U.S. v. Peter Madoff.* • The SEC settled fraud charges against Ronald Baldwin, Jr., former CFO of **JBI, Inc.** Baldwin was ordered to pay $25,000 in penalties and was barred for five years from acting as an officer or director of a public company. • The SEC settled fraud charges against **Diebold, Inc.** Diebold was ordered to pay $22,972,942 in disgorgement and prejudgment interest.

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Without the "fraud-on-the-market" presumption, putative class action plaintiffs will likely be unable to maintain a securities fraud class action unless they can prove that each individual shareholder actually relied on the challenged statements when purchasing or selling securities.

General News

Future of Class Action Securities Suits in Doubt after Supreme Court Agrees to Review 'Fraud on the Market' Presumption

On November 15, 2013, the U.S. Supreme Court granted review in yet another class action, and this one may have significant implications for the future of securities-fraud litigation. In *Halliburton Co. v. Erica P. John Fund, Inc.*, the Court will consider whether to overrule or significantly limit the legal "fraud on the market" presumption it created in *Basic, Inc. v. Levinson* (1988), that each member of a securities fraud class action relied on the statements challenged as fraudulent in the lawsuit. Put simply, that theory says the stock price of a publicly-traded company reflects all known relevant information about the company. The theory is that when the company makes material misstatements about the company's financial situation or expected course of conduct, it defrauds the entire market, and the company's stock price is affected for all shareholders. *Basic* therefore held that an individual shareholder was entitled to a presumption of reliance on the company's material misstatements, even if he or she did not knowingly rely on them. Among other things, that presumption greatly simplifies class certification in a securities-fraud case and thus greatly increases the size and severity of securities class action settlements. The court in *Halliburton* accepted two issues for resolution: 1) Whether it should overrule or substantially modify the holding of *Basic*, to the extent that it recognizes a presumption of class-wide reliance derived from the fraud-on-the market theory; and 2) Whether, in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock. We will closely watch this case, which is expected to be decided in July of 2014. At least four Justices have recently indicated the Court should reconsider the validity of that doctrine, suggesting that the ultimate opinion in *Halliburton* could lead to a significant change in securities class action law. Without the "fraud-on-the-market" presumption, putative class action plaintiffs will likely be unable to maintain a securities fraud class action unless they can prove that each individual shareholder actually relied on the challenged statements when purchasing or selling securities. A possible outcome from question 2 above is that the Court may expand defendants' ability to defeat what in practice has evolved into a virtually irrefutable presumption of reliance.

The theory is that when the company makes material misstatements about the company's financial situation or expected course of conduct, it defrauds the entire market, and the company's stock price is affected for all shareholders.

Increased FCPA Enforcement to Continue With Assistance of Corporate Attorneys

During a recent conference of business attorneys focused on the Foreign Corrupt Practices Act (FCPA), U.S. Deputy Attorney General James M. Cole stressed the importance of corporate attorneys working with federal agencies to identify and rectify misconduct. In addition, he warned of serious consequences for companies who try to hide misconduct or mislead investigators. Benefits of self-disclosure and active mitigation of FCPA violations, or potential violations, include non-prosecution agreements or deferred prosecution agreements. In his remarks, Mr. Cole asserted "the FCPA has become a model for a common legal standard emerging across the globe that rejects the notion that bribery in international business transactions is lawful, much less inevitable." Other regulators at the SEC echoed these sentiments and said companies operating internationally can expect increasing scrutiny from law enforcement working across borders and with greater resources than in the past. Hinting at what's in the pipeline, the speakers noted the Department of Justice (DOJ) is expected to bring very significant cases in the upcoming year. Companies who simply inform regulators they have implemented FCPA training programs can expect a host of follow-up questions. "Training is insufficient. It's about segregation of duties, internal audit, testing ... [and

assurances] that you're going to catch the next problem and hopefully prevent it." Since 2011, the DOJ has reached 27 corporate resolutions and at least 28 individuals have been charged with FCPA or related violations. The corporate cases have resulted in penalties of $758 million, with that sum only likely to grow in the future.

SEC Provides Guidance on Social Media and Regulation FD Compliance

Largely as a result of Netflix CEO Reed Hasting's 2012 Facebook post in which he disclosed the company's monthly viewership results, the Securities and Exchange Commission (SEC) has renewed its focus on social media as it relates to Regulation FD, which prohibits companies from disclosing material, nonpublic information on a selective basis, thus ensuring "fair disclosure" to all investors. Hastings is not alone in inviting such scrutiny. The CEO of WebMediaBrands also attracted negative attention from the SEC in 2010 when he posted news on Twitter concerning the company's financial results and acquisitions; and in 2012, the CFO of Francesca's Holding Corp. was terminated for tweeting "Board meeting. Good numbers=Happy Board" before an earnings announcement. While Lona Nallengara, Acting Director of the SEC's Division of Corporation Finance, has encouraged companies to "review the Commission's existing guidance," suggesting "it is flexible enough to address questions that arise for companies that choose to communicate through social media ... in a straightforward manner," the SEC has conversely recognized that the "regulation does not require use of a particular method, or establish a 'one size fits all' standard for disclosure." The SEC has consequently cautioned issuers that "a deviation from their usual practices for making public disclosure may affect [the SEC's] judgment as to whether the method they have chosen in a particular case was reasonable." This lack of clarity and ambiguity in the SEC's guidelines ultimately led to the SEC's decision not to institute enforcement proceedings against Netflix and Mr. Hastings. Instead, the SEC clarified that companies may use social media to share information with investors as long as investors' access to social media is not restricted, and investors are alerted to which social media sites will be used to distribute information. "We emphasize for issuers that the steps taken to alert the market about which forms of communication a company intends to use for the dissemination of material, non-public information, including the social media channels that may be used and the types of information that may be disclosed through these channels, are critical to the fair and efficient disclosure of information. Without such notice, the investing public would be forced to keep pace with a changing and expanding universe of potential disclosure channels, a virtually impossible task." Given these recent events, it is critical that companies incorporate the use of social media into corporate policies to maintain compliance with Regulation FD, while keeping the following key points in mind: 1) limit social media use to authorized, trained individuals; 2) notify investors of the social media sources to be used; 3) assess what information is considered "material" and err on the side of caution if uncertainty exists; and 4) implement disclosure controls ("Safe Harbor") in the event material information is inadvertently disclosed via social media. With appropriate and thoughtful procedures in place, companies can avoid noncompliance with Regulation FD and be protected against disclosure events that may lead to Rule 10b-5 fraud or insider trading claims.

"We emphasize for issuers that the steps taken to alert the market about which forms of communication a company intends to use for the dissemination of material, non-public information, including the social media channels that may be used and the types of information that may be disclosed through these channels, are critical to the fair and efficient disclosure of information."

Plaintiffs Drop Appeal in Case Upholding Delaware Forum Selection Bylaws

As an update to the *Chevron* case discussed in the June 2013 *Month in Review*, plaintiffs have dropped their appeal to the Delaware Supreme Court challenging the Chancery Court's ruling that forum selection bylaws are statutorily and contractually valid. In the much anticipated *Chevron* opinion, Chancellor Strine rejected challenges to the validity of bylaw provisions mandating Delaware as the exclusive forum for certain types of litigation. The consequence of this latest action is that board-adopted forum selection bylaws are valid and enforceable under Delaware law. However, as explained in the June *Month in Review*, a conflict between the courts exists with two federal courts in California refusing to enforce similar forum selection bylaw provisions. Aon will continue to monitor whether other courts will follow the Delaware Chancery Court now that the plaintiffs have surrendered their appeal.

The consequence of this latest action is that board-adopted forum selection bylaws are valid and enforceable under Delaware law.

Cases Of Interest

Section 10(b) and Rule 10b-5 Do Not Govern Extraterritorial Conduct in Civil or Criminal Cases

This case provided a federal appellate court with the opportunity to decide whether criminal liability under Section 10(b) of the Securities Exchange Act of 1934 extends to conduct in connection with an extraterritorial purchase or sale of securities. In holding that Section 10(b) and its implementing regulation, Rule 10b-5, do not apply to extraterritorial conduct regardless of whether liability is sought civilly or criminally, the court found liability is contingent upon the actor engaging in fraud in connection with: 1) a security listed on a U.S. exchange; or 2) a security purchased or sold in the U.S. The court further clarified that in a criminal case, the government need not show actual reliance on the alleged misrepresentations or omissions because that is not an element required to establish criminal liability. Turning to the facts of the case, the defendants acted as investment managers and advisers using a number of different domestic and foreign companies as vehicles for investing. While assuring investors their money had been invested in a prudent manner with no more than 25 percent of the accounts holding emerging growth stocks, in reality, the funds were fully invested in highly volatile technology and biotechnology stocks. In the early 2000s, the scheme began to unravel and in 2005, the investors reported their concerns to the SEC. The defendants were subsequently indicted and found guilty of securities fraud, conspiracy to commit securities fraud, mail fraud, wire fraud, money laundering and making false statements to the SEC. Acknowledging the securities at issue were not listed on U.S. exchanges and the U.S. Supreme Court's decision in *Morrison v. National Australia Bank* changed the landscape of the law, the court reviewed the trial transcript to determine if a different result was warranted following the Morrison decision. The court ultimately concluded the jury would have found the defendants' conduct sufficiently connected to securities fraud in the U.S. based on visits to the U.S. and investment materials being executed within the U.S. to support the convictions under Section 10(b). Finally, the court remanded the case to the district court for recalculation of the defendants' sentences and amounts to be forfeited based on Section 10(b)'s inapplicability abroad. *U.S. v. Vilar*, 2013 U.S. App. LEXIS 1814 (2nd Cir. 2013).

Allegations of Intentional Conduct Are Not Wrongful Acts as Defined by E&O Policy

... "an exclusion cannot expand the scope of coverage beyond that provided in the insuring agreement" ...

The insured sought coverage under an E&O policy for an underlying lawsuit alleging it interfered with contractual rights, interfered with a business relationship/opportunity, and participated in a civil conspiracy. The insurer denied coverage for several reasons, including that the underlying complaint failed to allege a "Wrongful Act," defined by the policy as "any actual or alleged negligent act, error or omission." The court found the insurer's duty to defend was not triggered. The court first examined the defense provision of the policy which provided that the insurer had the duty to defend the insured against any "covered claim." Next, the court found that "the term 'wrongful acts' controls the types of legal claims that are covered under the policy." Because the policy defined "Wrongful Act" as "any actual or alleged negligent act, error or omission," the insurer was not required to defend the insured unless the complaint alleged negligent conduct. Here, none of the factual allegations in the complaint sounded in negligence. Finally, the court rejected the insured's argument that based on the fraud exclusion in the policy, the insurer had a duty to defend against intentional misconduct. The exclusion provided that the insurer "will defend the insured against such claim unless or until the dishonest, fraudulent...or knowingly wrongful act has been determined by any trial verdict, court ruling or legal admission." The court reasoned that "[e]xclusions limit the scope of coverage; an exclusion cannot expand the scope of coverage beyond that provided in the insuring agreement," meaning the insuring clause was not

triggered and no duty to defend existed. *Matthew T. Szura & Co. v. General Ins. Co. of Am.*, 2013 U.S. App. LEXIS 22764 (6th Cir. 2013).

Investment Bank Ordered to Pay Legal Fees of Former Employee in Stolen Secrets Case

A federal judge in Newark, NJ has ordered a large financial institution to advance the legal fees of a former employee who has been criminally charged with stealing proprietary computer source code from the firm. The question of whether the former employee, who was a computer programmer at the firm, is entitled to advancement of his legal fees turned on the former employee's status as an "officer" under the company's bylaws. The employee claimed to be an "officer" of the firm because he held the title of Vice President. The firm countered by arguing that the title was merely functional and that an officer, as the term is used in its bylaws, means an individual appointed as such pursuant to a formal resolution process. The firm is a Delaware corporation and thus the court analyzed Section 145 of the Delaware General Corporation law, which authorizes corporations to indemnify their current and former corporate officials from expenses incurred in legal proceedings, along with the firm's by-laws. Based on a broad interpretation of the bylaws provision and the court's recognition of Delaware's statutory policy favoring immediate advancement, the court ruled in favor of the former employee. The firm has appealed the ruling. *Aleynikov v. The Goldman Sachs Group, Inc.*, 2013 U.S. Dist. Lexis 151603 (D.N.J. 2013).

The question of whether the former employee ... is entitled to advancement of his legal fees turned on the former employee's status as an "officer" under the company's bylaws.

Professional Services Exclusion in D&O Policy Bars Coverage for Class Action against Broker-Dealer

In this case, a federal appellate court upheld a lower court's ruling that a D&O insurer's professional services exclusion precluded coverage for a securities broker-dealers' litigation arising out of alleged misleading statements made to investors in a REIT. The underlying matter involved a disciplinary proceeding by FINRA against the broker-dealer alleging it misrepresented the value of certain REIT shares sold to investors, and failed to perform adequate due diligence in marketing those shares. Subsequently, three related class actions were also brought against the broker-dealer. The insured tendered the FINRA proceeding and the class actions to its D&O insurer, which denied coverage based upon a "professional services" exclusion precluding coverage for any claim arising from the broker-dealer's performance of, or failure to perform, "professional service for others." The insured sued its insurer arguing that "professional services" was not a defined term in the policy and coverage should exist for both matters. The insured further argued that financial advisors are not classified as professionals under New York state malpractice law and therefore could not perform "professional services" for purposes of coverage under the policy. The lower court disagreed, holding that the professional services exclusion was unambiguous and clearly included the insured's due diligence in providing investment advice. The lower court also found the exclusion was not ambiguous merely because the words were undefined in the policy and rejected the broker-dealer's argument that financial advisors are not "professionals" because in the context of insurance, "professional services" encompasses a broader range of conduct. The insured then appealed; however, the appellate court affirmed the lower court's decision finding the claims for which coverage was sought fell within the professional services exclusion. Citing New York law, the appellate court held the insured's actions were "professional services," as they were performing due diligence on [securities] and marketing those securities, which required specialized knowledge or skill, and the skill is mental rather than physical. The decision turned on the standard test for professional services under New York law, meaning employees acted with the "special acumen and training of professionals when they engaged in the acts." Accordingly, the professional services exclusion barred coverage for the claims against the broker-dealer. *David Lerner Assocs., Inc. v. Philadelphia Indem. Ins. Co.*, 2013 U.S. App. Lexis 23386 (2nd Cir. 2013).

Business Exclusions Negate Duty to Defend and Indemnify Advertising Injuries

A court recently held that the "business exclusions" in primary and excess commercial general liability policies negated any duty to defend or indemnify an insured for alleged advertising injuries. The coverage dispute arose from a patent infringement suit brought against the insured. The court originally held that the alleged underlying injuries were not "advertising" injuries, and thus, the "advertising injury" coverage section of the policies did not apply. The appellate court reversed that holding and directed the district court to consider various issues. The insurers subsequently pointed to the business exclusions which provided, in relevant part, that "[t]his insurance does not apply to ... [a]n offense committed by an insured whose business is advertising, broadcasting, publishing or telecasting." The insurers argued that the exclusion applied since the insured is a direct satellite broadcaster. The insured countered that the satellite television programming it provides should not be considered "broadcasting" because it is a subscription service not available to the "indiscriminate public" or the "public generally." The court found for the insurers, reasoning there is no requirement that every member of the public actually see what is broadcast or have access to the broadcast for free before the broadcast will be considered directed toward the "public at large." The court further opined that the plain meaning of "broadcasting" includes the business of providing satellite television programming, in which the insured is primarily engaged. "For [the insured] to hold itself out to the public and courts as a 'broadcaster' but then to deny the same to avoid its insurers' broadcasting exclusion, smacks of hypocrisy and not common sense or understanding." Finally, the court noted that the insured's broker explicitly warned the insured they would not be covered for many injuries because of the broadcasting exclusion. *Dish Network Corp. v. Arch Spec. Ins. Co.*, 2013 U.S. Dist. LEXIS 151520 (D. Colo. 2013).

Customer Funds Exclusion Precludes Coverage for Misappropriation of Fees

The court found the complaint linked all the allegations regarding the failure to record mortgage documents with the scheme to misappropriate the escrowed funds.

An insured title insurance company purchased a professional liability insurance policy which provided coverage for a "negligent act, error, omission, misstatement, misleading statement, neglect or breach of duty ... by an Insured, in the performance of or failure to perform Professional Services." The policy did exclude coverage for any Claim "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged ... loss, disappearance, pilferage or shortage of, or commingling or improper use of, or failure to segregate or safeguard, any client or customer funds, monies, or securities." The insured was sued by a client, which alleged the insured had deliberately delayed the recording of mortgage instruments to benefit from the cash in escrow for the purpose of paying recording fees. At least one cause of action alleged negligence in that the insured failed to file the mortgages and other closing documents, and failed to use the funds to pay off refinanced mortgages. The carrier asserted the customer funds exclusion was applicable and precluded coverage in its entirety, and the insured argued that some of the causes of action alleged fell outside the scope of the exclusion such that coverage could be available. The court found for the carrier, noting that the "arising out of" language is given broad meaning, and means "originating from," "growing out of" or "flowing from" and "causally connected with." Thus, a "but for" relationship would satisfy the policy provision. The court found the complaint linked all the allegations regarding the failure to record mortgage documents with the scheme to misappropriate the escrowed funds. So, as alleged, the insured failed to record the instruments only because it was a component of a broader scheme to misappropriate funds. Thus, there was a direct cause and effect relationship between all the alleged conduct and the loss or improper use of customer funds and the complaint fell completely within the exclusion. Although the insured argued the failure to record mortgage instruments could occur in the absence of misappropriation, the court "would not imagine allegations that [the plaintiff] could have made merely because its actual allegations went beyond the bare minimum of notice pleading." *Bethel v. Darwin Select Ins. Co.*, 2013 U.S. App. LEXIS 23183 (8th Cir. 2013).

Third Circuit Concludes 'Discovery Rule' Triggers Statute of Limitations for 1933 Securities Act Claims

A pension trust fund purchased mortgage-backed securities whose offering instruments promised investors the underlying loans were originated to specific underwriting methods, practices, and procedures and complied with state and federal rules. The offering instruments also claimed there were no pending material legal proceedings against the sponsor, depositor or issuing entity of the securities. During the financial crisis, rating agencies downgraded the securities, which resulted in the value of the securities substantially decreasing and recognized other potential claims it could assert. The 1933 Securities Act (Securities Act) mandates lawsuits must be brought "within one year after the discovery of the untrue statement or the omission or after such discovery should have been made by the exercise of reasonable diligence." The federal trial court applied an "inquiry notice" standard and dismissed the lawsuit as untimely. On appeal, the federal appellate court concluded a Securities Act plaintiff is not required to plead compliance with the statute of limitations. It highlighted that because a statute of limitations is an affirmative defense, the burden of establishing its applicability rests with the defendant and requiring a plaintiff to plead compliance with a statute of limitations improperly shifts the burden to the plaintiff. The court went on to decide the statute contained a "discovery standard," rather than an "inquiry notice standard." Under the discovery standard, a claim accrues when the plaintiff did in fact discover, or when a reasonably diligent plaintiff would have discovered the facts constituting the violation, whichever comes first, instead of the inquiry standard, which points to facts that would lead a reasonably diligent plaintiff to investigate further. Thus, Securities Act plaintiffs need not plead compliance with the statute of limitations, an interpretation adopted by three of its sister Circuit courts and rejected by another three, setting the question squarely for U.S. Supreme Court to ultimately decide. *Pension Trust Fund for Operating Engineers v. Mortgage Asset Securitization Transactions, Inc.,* 2013 U.S. App. LEXIS 19166 (3rd Cir. 2013).

Under the discovery standard, a claim accrues when the plaintiff did in fact discover, or when a reasonably diligent plaintiff would have discovered the facts constituting the violation.

SEC Filings	SEC Settlements
• Charles H. Merchant, Sr., CEO, CFO, president, secretary, treasurer and director and his company **Southern USA Resources, Inc.** The SEC is seeking disgorgement, prejudgment interest, penalties, and an order barring Merchant from serving as an officer or director of a public company.	• The SEC settled fraud charges against **Viking Financial Group, Inc.** and Steven Palladino, its owner and president, requiring them to pay more than $9.8 million in disgorgement and prejudgment interest. • The SEC settled fraud charges against **MedLink**, Aurelio Vuono, CEO, and James Rose, CFO. MedLink, Vuono, and Rose were ordered to pay jointly and severally, $158,415.98. In addition, the court ordered civil penalties of $650,000 against MedLink, $130,000 against Vuono, and $130,000 against Rose. Vuono and Rose were barred from serving as officers or directors of a public company. • The SEC settled FCPA charges against **Weatherford International**. Weatherford agreed to pay more than $250 million to settle the SEC's charges and parallel actions by the Department of Justice's Fraud Section, U.S. Attorney's Office for the Southern District of Texas, Department of Commerce's Bureau of Industry and Security, and Department of Treasury's Office of Foreign Assets Control.

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The year ahead may very well be characterized in the mantra of the Enforcement Division's co-director, "[w]e are focused on addressing wrongdoing in all corners of the financial industry. Going forward, we will continue to be aggressive but fair in our pursuit of those who violate the securities laws."

General News

SEC's 2013 Enforcement Results Top Historical Charts with Record Number of Monetary Sanctions

The Securities and Exchange Commission's (SEC) co-director said, "[n]umbers tell only a part of the story as we look to bring high-quality enforcement actions that make an impact across the market." Such is the tale of 2013 - the total number of action pursued declined but the recoveries were at record highs. In 2013, the agency brought 686 proceedings, a 6.5 percent downward trend from the 2012 and 2011 totals at 734 and 735, respectively. The agency successfully obtained an all-time record high $3.4 billion in disgorgement and penalties, which represents a 10 percent spike over 2012 and 22 percent increase over 2011. The $3.4 billion was comprised of securities violators paying $2.257 billion relating to disgorged illegal profits and $1.167 billion in penalties. The agency remained focused on the same top categories of enforcement actions: Investment Advisor/Investment Co (140), Delinquent Filings (132), Broker-Dealer (121) and Securities Offerings (103). The categories of actions were rounded out by FCPA actions, insider trading and market manipulation claims. The SEC touts various new initiatives contributing to its 2013 statistics, including the focus on "gatekeepers" (accountants, securities attorneys, transfer agents and more). These "gatekeepers" are described by the SEC as having "special duties to ensure that the interests of investors are safeguarded." The SEC's aggressiveness sought several significant actions against stock exchanges and other market participants on issues relating to market structure and fair market access. The SEC obtained its largest-ever penalty against an exchange with a $10 million penalty for the exchange's alleged poor systems and decision-making during a high profile IPO. The agency also continued its efforts to penalize those responsible for the economic crisis of 2008. As of the end of 2013, the agency had filed enforcement actions against 169 individuals (70 of whom were CEOs, CFOs or other senior executives) and entities arising from the financial crisis resulting in more than $3 billion in disgorgement, penalties, and other monetary relief benefitting harmed investors. The agency remained focused on insider trading against those who unlawfully trade on material, nonpublic information. The SEC filed 44 actions in 2013 with insider trading allegations including several against hedge fund managers for failure to supervise portfolio managers and prevent them from insider trading. While FCPA actions make headline news, it appears corporate awareness and the government's recent strict enforcement has caused businesses to take extra precautions in the way in which they conduct foreign transactions. The SEC's FCPA litigation spike in 2011 and 2012 plummeted in 2013. The SEC says enforcement actions were down two-thirds in 2013 from the previous year, with only five FCPA prosecutions by year end. The year ahead may very well be characterized in the mantra of the Enforcement Division's other co-director, "[w]e are focused on addressing wrongdoing in all corners of the financial industry. Going forward, we will continue to be aggressive but fair in our pursuit of those who violate the securities laws."

... [n]umbers tell only a part of the story as we look to bring high-quality enforcement actions that make an impact across the market.

Cases of Interest

Carrier Entitled to Rescind E&O Policy Based on Misrepresentations in Application

An insurance carrier sought to rescind a title agent's errors & omissions (E&O) insurance policy after its president was indicted on counts of mortgage fraud and making false statements in connection with loan applications, among other allegations. In the criminal plea agreement, the president admitted the acts for which he was pleading guilty began several years prior to the inception of the policy and continued for at least one year after. The underlying claim submitted to the carrier involved a customer who sued the insured for breach of fiduciary duty as an escrow agent because the insured released money without authorization from the customer. Based on the application, the carrier sought to rescind the E&O policy in full. Under Florida law, a misrepresentation in the application may prevent recovery under the policy if the misrepresentation was material to the acceptance of the risk or hazard assumed by the insurer. The carrier argued the president was obligated to answer "yes" when asked whether she was aware of circumstances that could lead to a professional liability claim because she was knowingly committing mortgage fraud at the time. The insured argued the answer to the question was correct, as the individual's criminal acts would not have been covered as a professional liability claim, since the criminal acts were intentional in nature, whereas the allegations in the customer lawsuit involved the negligent release of funds. The court found the president was not relieved of her duty to disclose the acts that "could result in a professional liability claim simply because the policy may not have covered those acts." Thus, there was a misrepresentation in the application. The court also concluded the misrepresentation need not be intentional as the policy language provided it would be void for the misrepresentation of a material fact and not only an intentional concealment of a fact. Finally, the court found the misrepresentation material in that the court did "not need an underwriter or guidelines to appreciate how not knowing [insured persons] had been committing mortgage fraud in excess of five years left [the carrier] unable to adequately estimate the nature of risk in issuing the policy." *Zurich Amer. Ins. Co. v. Diamond Title of Sarasota, Inc., et al.*, 2013 U.S. Dist. LEXIS 170981 (M.D. Fla. 2013).

Notice of Potential Claim Sufficient to Trigger Coverage Obligations Based on Ambiguities in D&O Policy Language

... "[w]hether the deemed date of the later Claim relieves the Insured of the obligation to give notice each time a later Claim is made is not sufficiently clear from the words of the Policy" ...

In this coverage dispute, the insured argued its insurer was obligated to pay litigation costs in five underlying cases. The suits against the insured, a satellite radio provider, were filed in connection with its directors' and officers' alleged mismanagement following efforts to have a merger approved. The insured provided notice of the first lawsuit as notice of a "potential claim," but did not provide notice of the later lawsuits. The insurer argued the insured failed to give timely notice of any of the underlying claims other than the first notice of a "potential claim" and failed to obtain the insurer's consent to incur defense costs in the five actions. The insurer relied on the notice provision of the policy which provided: "[a]s a condition precedent to any right to payment under this Policy with respect to any Claim, the Insured shall give written notice to the Insurer of any Claim as soon as practicable after it is first made." The insured countered it was not required to give prompt notice of the subsequent actions because those actions are all interrelated to the initial notice of potential claim and relied on the section of the policy that provided that "[a]ll Claims arising from the same Interrelated Wrongful Acts shall be deemed to constitute a single Claim and shall be deemed to have been made at the earliest of the time at which the earliest such Claim is made or deemed to have been made." The insurer replied that the interrelated claim provision had no bearing on the policy's separate notice requirement. The trial court disagreed, concluding that "[w]hether the deemed date of the later Claim relieves the Insured of the obligation to give notice each time

a later Claim is made is not sufficiently clear from the words of the Policy ... to require dismissal of the complaint." The court also held it could not dismiss the insured's cause of action for failure to pay defense costs. The insured introduced evidence that the initial notice requested the insurer's consent to incur defense costs and the record failed to establish the insurer gave its consent or refused to do so. Finally, the court dismissed the insured's request for attorneys' fees in the coverage action, holding that such fees are only available from the insurer when the insurer has filed suit against the insured. *Sirius XM Radio Inc. v. XL Spec. Ins. Co. and U.S. Spec. Ins. Co.*, 2013 N.Y. Misc. Lexis 5201 (N.Y. Sup. Ct. 2013).

Failure to Obtain Consent for Settlement under General Liability Policy Bars Coverage

This coverage dispute arose out of the construction of a hotel and conference center outside of Washington, D.C. after a structural component of the glass atrium failed, causing substantial damage and delaying completion. Several months after the settlement of this underlying dispute, the insured notified its insurer, which subsequently disclaimed coverage based on the following clauses: 1) No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense other than for first aid, without our consent; and 2) No person or organization has a right under this Coverage Part ... to sue [the insurer] on this Coverage Part unless all of its terms have been fully complied with. The appellate court agreed with ACE's contention that an "insured ... can [not] unilaterally settle a construction defect case ..., present the settlement to its liability insurer as a fait accompli, and [then] obtain indemnification" even though it failed to seek the insurer's consent as necessitated by the policy. The court rebuffed the insured's argument that Maryland state law required an insurer to suffer "actual prejudice" before denying coverage in a case where the insured failed to give the insurer requisite notice of a claim. Instead, the court concluded the no-action and voluntary payment provisions were "conditions precedent to ... coverage." Specifically, "because [the insured] did not meet the condition precedent in the no-action clause (that is, it did not obtain consent before settlement), it cannot now sue [its insurer]." *Perini/Tompkins Joint Venture v. ACE American Ins. Co.*, 2013 U.S. App. LEXIS 24865 (4th Cir. 2013).

Delaware Chancery Court Tasked with Determining CEO and Board Membership

Seven months after his removal, the founder and former CEO of a development firm asserted claims that he was still the CEO and, in his purported capacity as CEO, removed two outside directors from the board without cause and filled a different director seat. The court first found the CEO was barred from challenging his own removal. Because the CEO never contended the board violated a mandatory bylaw, his removal was potentially voidable, and not actually void as a matter of law. As a result, the claims by the CEO were subject to the defense that the CEO had understood the material facts surrounding his removal, but by waiting seven months to assert his claims, resulted in prejudice to the company. Additionally, the CEO's initial conduct made it reasonable for the board to believe he had accepted his removal. Next, the court held the former CEO remained a director after his termination and that he had validly filled a director's seat. The court noted this result could have been different had the qualifications for the various board seats appeared in a clear, self-executing provision of the certificate of incorporation. Instead, the board qualifications appeared in a stockholders' agreement. Finally, regarding the former CEO's attempt to remove the two outside directors, the court found that under the Stockholders' Agreement, the former CEO retained the right to remove directors without cause whom he had originally been entitled to designate. The court held the CEO had validly removed one of the two outside directors, but had not validly replaced him because the stockholders' agreement required that outside director seats be filled by nominees designated by the current CEO. *Klaassen v. Allegro Development Corp.*, 2013 Del. Ch. LEXIS 247 (Del. Ch. 2013).

Insured's Failure to Provide Timely Notice Bars Injured Third-Party's Direct Action

... since no coverage is available under the bank's policy due to the bank's breach of the notice provision, it follows that the plaintiff-account holder cannot maintain a claim against the bank's insurer ...

A Louisiana federal court ruled that an individual who claimed his money was stolen from his bank account could not pursue a direct action against his bank's insurer due to the bank's failure to timely report the claim. Louisiana is one of a handful of states with a direct action statute that grants injured third parties the right to sue the alleged wrongdoer's insurer. In this case, the claimant filed complaints with the Federal Deposit Insurance Corporation (FDIC) and the Louisiana Office of Financial Institutions (OFI), in June and July of 2008 respectively, demanding reimbursement of the amount he claimed was stolen from his account. Upon receipt, the FDIC and OFI forwarded the claimant's demands to the bank, which responded by September 2008 and denied all the allegations made against it. Less than nine months later, the claimant filed suit against the bank and others, including an unnamed insurance company that was later identified in an amended complaint. Upon being sued, the bank notified its insurer of the litigation. The notice provision in the bank's management and professional liability policy provided, in relevant part, that "the Insured shall, as a condition precedent to ... coverage ... give to the [insurer] written notice of a Claim as soon as practicable, but in no event later than ... 60 days after the date on which any insured first becomes aware that a Claim has been made." The lawsuit was noticed upon its filing, which was within the applicable policy period. However, because the court deemed the complaints filed with the FDIC and OFI to be "Claims" under the policy and because those agency complaints were not noticed, the bank was found to have breached the policy's 60-day notice provision. The court concluded that since no coverage is available under the bank's policy due to the bank's breach of the notice provision, it follows that the plaintiff-account holder cannot maintain a claim against the bank's insurer since the Louisiana direct action statute is clear that it does not expand coverage under liability policies; it only extends coverage to third parties where coverage is otherwise available. The plaintiff-account holder argued that even if technically the notice provision had not been complied with, the insurer waived its right to argue late notice. The court rejected the plaintiff's waiver argument stating there was no evidence in the record to show the insurer "ever took any other steps that were contrary to their intent to deny coverage" and did not engage "in inconsistent conduct" or exhibit "an actual intention to relinquish its right to deny coverage." *Joseph Grubaugh v. Central Progressive Bank, et al.*, 2013 U.S. Dist. LEXIS 177466 (E.D.La. 2013).

Ambiguities in Underlying Settlement and Insurance Agreement Result in Reinstatement of Claims

This case arose following the settlement of an underlying derivative action that excluded certain director and officer defendants. Said defendants had been excluded from settlement negotiations based on pending criminal charges against each, which were subsequently withdrawn after the partial settlement was consummated. To fund the partial settlement, the insured entered into a new insurance agreement with its insurers that provided the non-settling defendants would retain all rights under the original insurance policies. In turn, the insured agreed to indemnify the insurers if claims were made by the non-settling defendants for coverage in the settled derivative case, or claims of bad faith and any other claim that would otherwise be indemnified by the insured. The non-settling defendants eventually settled the underlying derivative case and initiated this coverage action against the insurers for bad faith and tortious interference with contract and/or prospective economic advantage. The trial court dismissed the coverage case; however, on appeal, the case was reinstated. At issue in this appeal was whether the promises made in the new insurance agreement barred the claims asserted in this case. While the trial court concluded the terms of the new insurance agreement did not bar the claims brought in this matter, it nevertheless reasoned that said claims were brought to undermine or invalidate the new insurance agreement. In reversing the trial court and reinstating the case, the appellate court held the bad faith and tort claims did not trigger the insureds'

indemnity obligations and the trial court erred in its assessment that, as a matter of law, the coverage case sought to void or invalidate the new insurance agreement. Moreover, it found the new insurance agreement expressly contemplated the prospect of a future bad faith claim and excluded any such claim from the insureds' indemnity obligations, so as to bring such claims outside the terms of the prior settlement agreement. As such, the claims asserted in this case for damages arising out the insurers' allegedly tortious conduct were not barred and the matter was remanded to the trial court, allowing the case to proceed. *Nicholas, III v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA., et al.*, 2013 Del. Lexis 632 (Del. 2013).

Court Rules in Favor of Excess Insurers by Holding Exhaustion Language Unambiguous

Washington's appellate courts follow a growing list of jurisdictions strictly construing excess insurers' policy language and holding that settling a claim with a primary D&O insurer negates excess coverage on the grounds that the primary policy was never "exhausted." In this case, the policyholder was an investment management company with a multilayered directors' and officers' insurance tower. The insured was embroiled in litigation (client investors) and regulatory investigations (IRS, DOJ, and US Senate Subcommittees) surrounding certain tax shelter transactions it offered wealthy clients to offset large capital gains. The various cases and investigations resulted in multi-million dollar settlements, indictments, and guilty pleas by the owners and senior managers of the insured. The insured sought coverage for the settlements and defense costs related to each of the above-noted proceedings. The primary insurer agreed to pay almost half of its $10 million policy limits. In an effort to trigger the excess policies in place, the insured agreed to pay the gap between the primary insurer's settlement contribution and its policy's limits. The insured then sought coverage from its excess insurers in this separate proceeding. The excess insurers denied coverage based on the "Depletion of Underlying Limits" provisions in the excess policies, arguing their policies were only triggered in the event of exhaustion of the underlying policy limits by reason of payment from each underlying insurer. The insured countered that the "exhaustion" language is a condition and the excess insurers did not establish either material breach or prejudice. The excess insurers replied that the exhaustion of the primary policy limits was the critical and defining feature of the excess policy's coverage and was set forth in plain and unambiguous terms. The court agreed with the excess insurers, finding the exhaustion language clear and unambiguous. The court followed well-established precedent in Washington, holding that the expectations of the insured cannot override the plain language of the contract. Accordingly, the excess insurer did not have to contribute to either the settlement or defense of the insured claim based on the primary policy never having been exhausted so as to trigger coverage under the excess policies. *Quellos Group v. Fed. Ins. Co.*, 2103 Wash. App. LEXIS 2626 (Wash. App. 2013).

The court agreed with the excess insurers, finding the exhaustion language clear and unambiguous.

Regulatory Complaint Deemed a Claim under E&O Policy

A real estate developer lodged a complaint with the Texas Department of Insurance (DOI) concerning a title insurance company. The complaint alleged the title company violated the Texas Insurance Code and asked for an injunction or damages. The DOI forwarded the complaint to the insured for response, and then mailed a letter to the developer indicating the department "concluded its investigation," and was "not capable of resolving disputes of fact." The DOI suggested the developer pursue other avenues against the title company, which resulted in the developer filing a civil suit based upon the same wrongful conduct and seeking virtually the same remedies it had from the DOI. The title company tendered the developer's lawsuit to its E&O insurer under a claims-made-and-reported policy, seeking defense and indemnity coverage. Notably, the insured never reported the initial regulatory complaint to the insurer, who subsequently denied coverage for the developer's lawsuit, taking the position that the claim arose before the policy period. Coverage litigation ensued with the insured arguing that, even though the regulatory complaint and the civil lawsuit alleged related

The regulatory complaint ... met the policy's definition of a claim because it was "a civil, administrative, or regulatory investigation against any insured commenced by the filing of a notice of charges, investigative order, or similar document."

wrongful acts under the policy, the regulatory complaint was not a claim within the meaning of the policy. The court disagreed, concluding the regulatory complaint was a claim because it was "a written demand against any insured for monetary or non-monetary damages," which fell squarely within one of the policy's definition of a claim. The court disregarded the insured's contention a claim was not made against any insured prior to the filing of the lawsuit because the developer sent the regulatory complaint directly to the DOI, not the insured. To this end, the court highlighted that the policy did not mention a demand must be sent directly from a claimant to the insured. As a result, a claim could be made against the insured through a third-party. The court also analyzed what actions the DOI took after receipt of the developer's complaint and concluded the DOI referred to its work as an "investigation," and also asked the insured for supporting documentation. The regulatory complaint, therefore, met the policy's definition of a claim because it was "a civil, administrative, or regulatory investigation against any insured commenced by the filing of a notice of charges, investigative order, or similar document." Accordingly, the court upheld the insurer's denial of coverage because the developer's lawsuit was a claim that arose before inception of the policy period. *Regency Title Co., LLC v. Westchester Fire Ins. Co.*, 2013 U.S. Dist. LEXIS 162772 (E.D. Tex. Nov. 2013).

TCPA Violations Not Considered Wrongful Acts as Defined by an E&O Policy

The insured in this coverage dispute was held liable in an underlying matter under the Telemarketing and Consumer Fraud and Abuse Prevention Act (TCPA) in an action brought by the Federal Trade Commission (FTC) and several states. The court found the insured specifically violated the "Telemarketing Sales Rule," which prohibits the provision of substantial assistance to a telemarketer when they know or consciously avoid knowing the telemarketer is engaged in acts that violate the regulations. The insurance carrier defended its insured, but argued there was no coverage for the judgment. The policy provided coverage for a "Wrongful Act," defined as a "negligent act, error or omission." The court held the conduct as found by the judge did not constitute negligence. It was "intentional and conscious wrongdoing or conscious avoidance of knowledge of other defendants' wrongdoing." Thus, it was not a "Wrongful Act" as defined in the policy and no coverage was available. With respect to whether the judgment qualified as "Damages" under the policy, the court noted that under Arizona law, damages awarded as restitutionary relief are not always uninsurable as a matter of public policy. Thus, the award would qualify as "Damages" even though it approximated the revenue earned by the insured for the acts in question. However, the court went on to hold that the regulatory exclusion applied, as the underlying case was brought by the FTC. Further, the illicit profit exclusion was found applicable because the damages arose "directly or indirectly" from "gain, profit or advantage" to which the insured was not legally entitled, and the conduct exclusion also applied to negate coverage for an act that a court found to be "intentionally committed while knowing it was wrongful." Thus, there was no coverage for the matter whatsoever. *FTC v. Affiliate Strategies, Inc.*, 2013 U.S. Dist. LEXIS 134436 (D. Kan. 2013).

Business Judgment Rule Shields Trustees from Derivative Claims as Long as Trustee Independence Not in Question

In putting this long running derivative suit to rest, a federal appellate court recently upheld a lower court's dismissal of claims alleging breach of fiduciary duty against trustees who recommended shareholder approval of a new investment advisory agreement. Following the sale of its investment advisory firm and the trustees' recommendation that shareholders approve the new investment advisory agreement, the shareholder claimant made a demand upon the board of trustees to investigate and bring a derivative proceeding. The trustees formed a committee to investigate the demand, issued a report, and ultimately decided it was not in the best interests of the trust to pursue a derivative proceeding. Unsatisfied, the

shareholder claimant filed a derivative proceeding, which was dismissed. On appeal, the shareholder claimant raised various arguments challenging the dismissal, all of which were rejected by the appellate court. Specifically, the court held that state law governed the special committee's investigation and rejection of the derivative demand, not the Investment Company Act of 1940, as urged by the claimant. Next, the court found allegations regarding the trustees' appointment, compensation, and workload were insufficient to support an inference of control by the investment advisory firm. The court noted the claimant would have to allege particular facts supporting an inference the trustees acted in a manner beneficial to themselves or the advisory firm to the detriment of the investors, but had failed to do so. "Mere speculation that a more favorable result might have been obtained is not sufficient to create a genuine issue as to trustees' independence." Having decided the issue of independence, the court reiterated that absent a showing of bad faith or lack of investigation into a demand, [Massachusetts] state law presumes the rejection of the demand to be a valid exercise of business judgment protected by the business judgment rule. While the claimant conceded his inability to overcome this presumption, he sought the opportunity to engage in discovery to obtain additional information to buttress his allegations. In rejecting this request, along with his request for leave to file an amended complaint, the court found the claimant's possession of the report issued by the special committee, along with over a thousand pages of exhibits, to be sufficient evidence from which he could have alleged particularized facts to justify his position and that further discovery was not warranted. As such, the court affirmed the dismissal of this case. *Halebian v. Berv*, 2013 U.S. App. Lexis 22801 (2nd Cir. 2013).

"Mere speculation that a more favorable result might have been obtained is not sufficient to create a genuine issue as to trustees' independence.""

Conflict between D&O Policy Condition and Endorsement Results in Coverage

In an opinion from earlier this year, a Texas appellate court reversed judgment in favor of the insurers based on conflicting policy language that should have been interpreted in favor of the insureds. The insured was sued in ten separate underlying cases, three of which were filed prior to the inception of its D&O policy, with the remaining seven having been filed during the relevant policy period. The insurers denied coverage, asserting all ten cases arose from the same facts and were deemed made prior to inception of the policy. On appeal, the appellate court was asked to determine if the interrelated provision in the policy, titled Condition C, and Endorsement 10 were in conflict, thereby creating an ambiguity as to the extent of coverage. Condition C provided that "all Claims, alleging, arising out of, based upon or attributable to the same facts, circumstances, situations, transactions or events will be considered to be a single Claim ... made at the time the earliest such Claim was made." Endorsement 10, on the other hand, stated that claims "arising out of, based upon or attributable to any pending or prior litigation as of 5/31/2000, or alleging or derived from the same or essentially the same facts or circumstances as alleged in such pending or prior litigation" were excluded from coverage. In finding Endorsement 10 to have a narrower effect, because it only excluded claims made during the policy period arising out of, based upon or attributable to any pending or prior litigation as of 5/31/2000, it was in conflict with Condition C, which would exclude a much broader set of claims. "Condition C goes even further than Endorsement 10 and bars coverage for such a Claim if the litigation against [the insured] was filed between May 31, 2000 and November 1, 2008 (the beginning of the Policy Period). This example confirms our conclusion that Condition C renders Endorsement 10's more narrow exclusion meaningless," thereby creating an ambiguity which must be resolved in favor of coverage for the insured. *Gastar Exploration Ltd. v. U.S. Spec. Ins. Co.*, 2013 Tex. App. Lexis 8738 (Tex. App. 2013).

Allegations of Stock Sales Alone Insufficient to Establish Securities Fraud

This opinion dismissed a Section 10(b) securities fraud class action complaint because it failed to allege a strong inference that the defendants acted with intent to deceive, manipulate, or defraud. The plaintiff relied on twelve stock sales made by five executives during the class period to argue the defendants had motive and opportunity to commit fraud. The court found that "whether a particular stock sale qualifies as 'unusual' depends on a number of factors, including: 1) the amount of net profits realized from the sales; 2) the percentages of holdings sold; 3) the change in volume of insider defendants' sales; 4) the number of insider defendants selling; 5) whether sales occurred soon after statements that defendants are alleged to have known were misleading; 6) whether sales occurred shortly before corrective disclosures or materialization of the alleged risk; and 7) whether sales were made pursuant to trading plans, such as Rule 10b5-1 plans." Here, the plaintiff failed to allege facts showing the identified stock sales were "unusual." First, the timing of the sales was not particularly suspicious as the majority of the sales were neither at the beginning of the class period, soon after the allegedly misleading statements, nor "clustered at its end, when insiders theoretically would have rushed to cash out before the fraud was revealed." Second, for at least three of the five executives at issue, the sales at issue represented only a small fraction of their total beneficial ownership, and the sales among all five executives totaled less than $10 million. Finally, all but one of the sales at issue were made pursuant to Rule 10b5-1 plans, adopted before the class period, that called for automatic sales at predetermined price points. As such, the complaint was dismissed for failure to meet the pleading requirements for claims asserted under Section 10(b) of the Exchange Act of 1934. *Koplyay v.Cirrus Logic, Inc.*, 2013 U.S. Dist. LEXIS 171109 (S.D.N.Y. 2013).

Here, the plaintiff failed to allege facts showing the identified stock sales were "unusual."

Court Rules Dozens of Lawsuits by Patients Subject to a Single Self-Insured Retention

In this coverage dispute, the court ruled that individual patient lawsuits brought against a provider of hospital management services constituted a single claim for purposes of determining the number of applicable retentions under its excess professional liability policies. The insured was sued in 71 separate lawsuits by individuals claiming they suffered numerous injuries after undergoing surgical procedures at a hospital managed by the insured. The allegations in the underlying complaints accused the insured of negligently managing the hospital by failing to implement proper policies and procedures and failing to supervise the hospital's doctors and staff. In the course of litigation between the insured and its insurers on matters relating to coverage, the insured's excess liability insurers advanced the position that each patient's claim is subject to a separate retention. The policies at issue contained two coverage parts - - a Healthcare Professional Liability part (HPL) and a Management Services Errors and Omissions part (E&O), added by endorsement. The HPL insuring clause was subject to a $6 million self-insured retention for each "medical incident" and the E&O coverage section was subject to a $5 million retention for each "occurrence." The court grappled with whether the underlying lawsuits arose out of a single "occurrence" or "medical incident," as those terms were used in the insuring agreements, thus requiring satisfaction of only one $5 million or $6 million, or whether they are multiple "medical incidents" or "occurrences", subject to separate retentions. The excess insurers did not dispute the underlying actions allege potentially covered claims under both coverage parts. The court held that the insured's alleged mismanagement of the hospital must be interpreted as one occurrence or medical incident under the policies. The judge, reading the policies so as to give all the terms and conditions meaning, stated, with regard to the E&O coverage, that, "In order to read the word 'occurrence' consistently with its use in the policy, and to honor the intent of the parties, the court holds that, as a matter of law, the ... policy must be read to impose a single [self-insured retention] for all claims flowing from a single alleged act of negligence on the part of the [insured]." In further support of the court's conclusion that a single retention should apply, the

judge stated with respect to the coverage under the HPL section that the "medical incident" triggering the insured's liability to pay claimants' damages is premised on the Insured's alleged mismanagement, not the individual medical procedures performed at the hospital. *CHS Community Health Systems, Inc., et al. v. Lexington Ins. Co., et al.*, 2013 U.S. Dist. LEXIS 175788 (M.D. Tenn 2013).

D&O Insurer Not Obligated to Defend Lawsuit Seeking Only Injunctive Relief

An insurer issued a non-profit D&O policy to a homeowners' association in which it agreed to pay "sums that the insured becomes legally obligated to pay as damages because of bodily injury, property damage, personal injury or advertising injury caused by an 'occurrence,'" as well as "damages because of 'wrongful acts' committed by an insured solely in the conduct of their management responsibilities for the Condominium/Association." The insurer also agreed to "defend any claim or suit seeking damages payable under this policy." Two residents sued the association for not enforcing community parking restrictions set forth in the covenants. The initial complaint asserted causes of action for breach of the covenants and nuisance, and sought injunctive relief. The first amended complaint included allegations that the insured's covenant violations caused the residents "irreparable injury" that "cannot be fully compensated in damages," along with injunctive relief. The residents did not assert and did not seek compensatory damages at that time. The insured notified the insurer of the suit and the insurer disclaimed coverage because the residents' claims did not seek damages payable under the policy. Subsequently, the residents filed a second amended complaint and asserted they had sustained damages "in an amount to be proved at trial or ... nominal damages to the extent necessary," and prayed for "damages ... or alternatively ... an award of nominal damages." The insurer agreed to defend the association under a reservation of rights beginning on the tender date of the second amended complaint; however, it declined to pay any of the insured's defense costs incurred prior to the tender of the second amended complaint. Coverage litigation followed. Because the policy only provided a defense for "any claim or suit seeking damages payable under this policy," the California appellate court concluded this provision abolished any defense obligation for suits seeking injunctive or other non-monetary relief, regardless of whether compensatory damages were implied in the underlying allegations. Specifically, the court rejected the insured's contention that the insurer had a duty to defend the underlying nuisance, breach of fiduciary duty, irreparable damage and punitive damages claims because they inherently required proof of actual damages, therefore giving rise "to the implication of actual damages." Accordingly, the court concluded "it is irrelevant that the third party might have suffered harm that could give rise to a claim for damages covered under the insured's policy. What matters is whether the third party has sought to recover damages from the insured." *San Miguel Comm. Assoc. v. State Farm General Ins. Co.*, 2013 Cal. App. LEXIS 836 (Cal. Ct. App. 2013).

"What matters is whether the third party has sought to recover damages from the insured."

SEC Filings	SEC Settlements
• The SEC filed fraud charges against **The Malom Group, AG** and Martin U. Schläpfer, CEO, managing director, and legal counsel; Hans-Jürg Lips, president or chairman of the board of directors; James C. Warras of Waterford, Wisc., who has been described as Malom's executive vice president and Joseph N. Micelli, compliance officer. The SEC is seeking permanent injunctions, disgorgement, prejudgment interest and civil penalties.	• Final judgment was entered against Thomas Gaffney, CEO and president of **Health Sciences Group**. Gaffney was permanently barred from acting as an officer or director. • The SEC settled fraud charges against **E-Monee.com**, Inc. and Estuardo Benavides, president, and one of its directors, Robert B. Cook. Benavides agreed to pay a civil penalty of $110,000. The SEC dismissed its civil penalty claim against E-Monee, which is no longer operating. The SEC remains in active litigation against Cook. • The SEC settled FCPA violation charges against **Archer-Daniels-Midland Company (ADM)**. ADM was ordered to pay disgorgement of $33,342,012 plus prejudgment interest of $3,125,354, and is required to report on its FCPA compliance efforts for a three-year period.

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Admiral Ins. Co. v Wilson, 2013 U.S. Dist. LEXIS 47009 (W.D. La. 2013)	April	**Trustee's Claim is brought in Right of the Bankruptcy Estate and is Not Barred by IvI Exclusion**
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Biochemics, Inc. v. Axis Reinsurance Co., 2013 U.S. Dist. LEXIS 111218 (D. Mass. 2013)	August	**Court Finds in Favor of Insurer on Extrinsic Evidence and Interrelated Wrongful Acts Language in D&O Policy**
Britt v. Twin City Fire Ins. Co., 2013 U.S. Dist. LEXIS 135183 (C.D. Ca. 2013)	August	**Portfolio Company's D&O Policy Does Not Cover Individual Acting in 'Capacity' as Manager of Private Equity Firm**
Carolina Cas. Ins. Co. v. Merge Healthcare Solutions, Inc., 2013 U.S. App. LEXIS 14342 (7th Cir. 2013)	July	**Award of Attorney's Fees in Merger Objection Suit Determined by 'Lodestar' Method Covered Despite Policy Exclusion for Punitive or Multiplied Damages**
Carolina Cas. Ins. Co. v. Omeros Corp., 2013 U.S. Dist. LEXIS 38811 (W.D. Wash. 2013)	March	**Additional Claims Included in Amended Complaint Covered Under Related Wrongful Act Provision**
Certain Interested Underwriters at Lloyd's, London v. Axa Equitable Life Ins. Co., 2013 U.S. Dist. LEXIS 85444 (S.D. Fla. 2013)	June	**Guilty Plea Triggers Conduct Exclusion**
Chicago Ins. Co. v. CWN Group, Inc., 2013 U.S. App. LEXIS 2780 (6th Cir. 2013)	March	**Rescission Upheld On Basis of Misrepresentations on E&O Policy Application**
CHS Comm. Health Sys., Inc., et al. v. Lexington Ins. Co., et al., 2013 U.S. Dist. LEXIS 175788 (M.D. Tenn. 2013)	December	**Court Rules Dozens of Lawsuits by Patients Subject to a Single Self-Insured Retention**
City of Orlando Police Pension Fund v. Page, 2013 U.S. Dist. LEXIS 139904 (N.D. Ca. 2013)	September	**Refusal of Derivative Demand Found Improper and Contrary to Evidence**
Clark School for Creative Learning, Inc. v. Phila. Indem. Ins. Co., 2013 U.S. App. LEXIS 21568 (1st Cir. 2013)	October	**Known Circumstances Exclusion Barred Coverage under D&O Policy**
Cohen, et al. v. Lovitt & Touche, Inc., 2013 Ariz. App. LEXIS 191 (Ariz. App. 2013)	September	**Arizona Public Policy Does Not Prohibit Insurance Coverage for Restitutionary Damages**
Commodore Plaza Condo. Ass'n, v. QBE Ins. Corp., 2013 U.S. Dist. LEXIS 5195 (S.D. Fla. 2013)	January	**Broad "Arising out of" Language Bars Entire Claim**
Continental Cas. Co. v. Marshall Granger & Co. LLP, et al., 2013 U.S. Dist. LEXIS 13541 (S.D.N.Y. 2013)	March	**Judge Denies Motion to Dismiss Rescission Action**
Cousins Submarines, Inc. v. Fed. Ins. Co., 2013 U.S. Dist. LEXIS 17306 (E.D. Wis. 2013)	February	**Contract Exclusion in D&O Policy Only Partially Precludes Coverage for Inducement, Misrepresentation and Rescissory Damages**
David Lerner Assoc., Inc. v. Phila. Indem. Ins. Co., 2013 U.S. Dist. LEXIS 46333 (E.D.N.Y. 2013)	April	**'Professional Services' Exclusion in D&O Policy Bars Coverage for Regulatory and Class Action Claims**

Case Cited	Month	Article Title
David Lerner Assocs., Inc. v. Phila. Indem. Ins. Co., 2013 U.S. App. Lexis 23386 (2d Cir. 2013)	November	**Professional Services Exclusion in D&O Policy Bars Coverage for Class Action against Broker-Dealer**
Davis v. Bancinsure, 2013 U.S. Dist. LEXIS 46249 (N.D. Ga. 2013)	March	**Insured v. Insured Exclusion and Defective Notice of Circumstance Bar Coverage**
Dish Network Corp. v. Arch Spec. Ins. Co., 2013 U.S. Dist. LEXIS 151520 (D. Colo. 2013)	November	**Business Exclusions Negate Duty to Defend and Indemnify Advertising Injuries**
Employer's Fire Ins. Co. v. Promedica Health Sys., 2013 U.S. App. LEXIS 8943 (6th Cir. 2013)	April	**FTC Investigation Not a Claim under Private D&O Policy**
EMS Fin. Serv., LLC v. Fed. Ins. Co., 2013 Bankr. LEXIS 139 (Bankr. E.D.N.Y. 2013)	January	**Errors and Omissions Insurance Policy Proceeds Deemed Asset of Debtor's Estate**
Exec. Risk Indem., Inc. v. Cigna Corp., 2013 PA Super. LEXIS 1662 (Pa. Super. 2013)	July	**Insured's Failure to Prove Proper Allocation of Covered and Uncovered Claims Results in Victory for Insurer**
Fidelity Bank v. Chartis Spec. Ins. Co., 2013 U.S. Dist. LEXIS 110935 (N.D. Ga. 2013)	August	**Overdraft Fees Not Covered Based on Fee Exclusion**
FTC v. Affiliate Strategies, Inc., 2013 U.S. Dist. LEXIS 134436 (D. Kan. 2013)	December	**TCPA Violations Not Considered Wrongful Acts as Defined by an E&O Policy**
Gabelli, et al. v. Securities and Exchange Commission, 2013 U.S. LEXIS 1861 (2013)	February	**U.S. Supreme Court Holds Discovery Rule Inapplicable to the SEC, Resulting in Dismissal of Claims Brought Over Five Years after Fraudulent Conduct Occurred**
Gastar Exploration Ltd. v. U.S. Spec. Ins. Co., 2013 Tex. App. Lexis 8738 (Tex. App. 2013)	December	**Conflict between D&O Policy Condition and Endorsement Results in Coverage**
Gibbons v. Malone, 2013 U.S. App. LEXIS 398 (2d Cir. 2013)	January	**Disgorgement Inappropriate under 'Short-Swing Profit Rule' for Sale and Purchase of Separate Securities by Corporate Insider**
Halebian v. Berv, 2013 U.S. App. Lexis 22801 (2d Cir. 2013)	December	**Business Judgment Rule Shields Trustees from Derivative Claims as Long as Trustee Independence Not in Question**
Harris v. Amgen, Inc., 2013 U.S. App. LEXIS 11223 (9th Cir. 2013)	June	**Ninth Circuit Holds Moench Presumption Inapplicable When Pension Plans Did Not Require or Encourage Investment in Company Stock**
Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C., 2013 Cal.App. LEXIS 455 (Cal. App. 2013)	July	**Insurer Barred from Bringing Action against Independent Counsel**
Hrobuchak v. Fed. Ins. Co., 2013 U.S. Dist. LEXIS 74160 (M.D. Pa. 2013)	May	**Trade Practices Exclusion and Loss Carve-Outs Inapplicable to Judgment against Debt Collector**
Impac Mortg. Holdings, Inc. v. Houston Cas. Co., 2013 U.S. Dist. LEXIS 27190 (C.D. Cal.)	February	**Suit Involving Mortgage-Backed Securities Are Not 'Securities' under D&O Policy and E&O Exclusion Applies**
In re BP P.L.C., 2013 U.S. Dist. LEXIS 142946 (S.D. Tex. 2013)	October	**Insured Loses Bid to Send Securities Suit Abroad**
Ind. State Dist. Council v. Omnicare, Inc., 2013 U.S. App. LEXIS 10385 (6th Cir. 2013)	May	**Plaintiffs Not Required to Plead Knowledge in Section 11 "Soft Information" Case**
Indian Harbor Ins. Co. v. City of San Diego, 2013 U.S. Dist. LEXIS 137873 (S.D.N.Y. 2013)	September	**Denial Based on Notice Not Being Provided 'As Soon As Practicable' Upheld and New York's Notice-Prejudice Rule Found Inapplicable**
Intelligent Digital Sys., LLC v. Beazley Ins. Co., Inc., 2012 U.S. Dist. LEXIS 170922 (E.D.N.Y. 2012)	January	**Whether Board Member was 'Duly Elected or Appointed' is Central to Application of IvI Exclusion**
J.P. Morgan Securities Inc. v. Vigilant Ins. Co., 2013 N.Y. LEXIS 1465 (N.Y. 2013)	June	**$160 Million 'Disgorgement' Settlement with SEC Covered under D&O Program**
Joseph Grubaugh v. Cent. Progressive Bank, et al., 2013 U.S. Dist. LEXIS 177466 (E.D.La. 2013)	December	**Insured's Failure to Provide Timely Notice Bars Injured Third-Party's Direct Action**
Kilcher, et al. v. Continental Cas. Co., 2013 U.S. Dist. LEXIS 46658 (D. Minn. 2013)	April	**Single Lawsuit Consists of Multiple Claims**
Klaassen v. Allegro Dev. Corp., 2013 Del. Ch. LEXIS 247 (Del. Ch. 2013)	December	**Delaware Chancery Court Tasked with Determining CEO and Board Membership**
Koplyay v.Cirrus Logic, Inc., 2013 U.S. Dist. LEXIS 171109 (S.D.N.Y. 2013)	December	**Allegations of Stock Sales Alone Insufficient to Establish Securities Fraud**
Kraft v. Thompson, 2013 Wisc. App. Lexis 173 (Wis. Ct. App. 2013)	February	**Improper Withdrawal of Defense Entitles Insured to Coverage and Precludes E&O Insurer from Contesting Coverage**
Landmark American Ins. Co. v. The Indus. Dev. Bd. of the City of Montgomery, 2013 U.S. Dist. LEXIS 128041 (M.D. Ala. 2013)	September	**Contract Exclusion in D&O Policy Precludes Coverage for Defense Costs**

Case Cited	Month	Article Title
Lemons v. Mikocem, 2013 U.S. Dist. LEXIS 133976 (E.D. Mich. 2013)	September	**Notice of Circumstance Insufficient to Preserve Coverage and Claim Did Not Relate Back to Prior Policy Period**
Lexington Ins. Co. v. Horace Mann Ins. Co., 2013 U.S. Dist. LEXIS 127544 (N.D. Ill. 2013)	September	**Letter Written to Defense Counsel Seeking Extracontractual Damages in Underlying Litigation Not a Claim under ICPL Policy**
Lexington Ins. Co. v. Integrity Land Title Co., 2013 U.S. App. LEXIS 15621 (8th Cir. 2013)	August	**E&O Coverage Unavailable for Title Agency with Prior Knowledge of Claim**
Liberty Ins. Underwriters, Inc. v. Perkins Eastman Architects, P.C., 2012 N.Y. App. Div. LEXIS 9060 (N.Y. App. Div. 2012)	January	**Notice of Circumstance Sufficient for Coverage to Attach to Subsequent Lawsuit**
Liu v. Siemens A.G., 2013 U.S. Dist. LEXIS 151005 (S.D.N.Y. 2013)	October	**Dodd-Frank's Anti-Retaliation Provision Does Not Apply Extraterritorially**
Lockheed Martin Corp. v. Admin. Rev. Bd., 2013 U.S. App. LEXIS 11159 (10th Cir. 2013)	June	**Tenth Circuit Broadly Interprets Sarbanes Oxley's Whistleblower Provisions**
Marinemax, Inc. v. Nat'l Union Ins. Co. of Pittsburgh, 2013 U.S. Dist. LEXIS 14641 (M.D. Fla. 2013)	February	**Contract Exclusion in Professional Liability Policy Inapplicable Where Cause of Action is Independent from Contract**
Matthew T. Szura & Co. v. Gen. Ins. Co. of Am., 2013 U.S. App. LEXIS 22764 (6th Cir. 2013)	November	**Allegations of Intentional Conduct Are Not Wrongful Acts as Defined by E&O Policy**
Max Spec. Ins. Co. v. A Clear Title and Escrow Exchange, LLC, et al., 2013 U.S. Dist. LEXIS 108864 (M.D. Fla. 2013)	July	**Guilty Plea in Criminal Case Triggers Fraud Exclusion in E&O Policy**
Mehdi Ali v. Fed. Ins. Co., 2013 U.S. App. LEXIS 11384 (2d Cir. 2013)	June	**Excess Coverage Triggered When Liability Payments, Not Obligations, Reach Attachment Point**
MSO Wash., Inc. v. RSUI Group, Inc., 2013 U.S. Dist. LEXIS 65957 (W.D. Wash. 2013)	May	**Over Billing Practices Asserted in False Claims Act qui tam Complaint is not a "Professional Service"**
Mt. Hawley Ins. Co. v. Lopez, 2013 Cal. App. LEXIS 346 (Cal. App. 2013)	May	**California Code does not Preclude Defense for Federal Criminal Actions**
Nat'l Bank of Cal. V. Progressive Cas. Ins. Co., 2013 U.S. Dist. LEXIS 48504 (C.D. Cal. 2013)	May	**Fraud Exclusion Bars Arbitration Award; No Coverage for Pre-Tender Fees under Duty to Indemnify Policy**
Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Mead Johnson & Co., 2012 U.S. Dist. LEXIS 179312 (S.D. Ind. 2012)	January	**Insurer's Claim Files are Not Discoverable Due to Unambiguous Policy Language**
Nicholas, III v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA., et al., 2013 Del. Lexis 632 (Del. 2013)	December	**Ambiguities in Underlying Settlement and Insurance Agreement Result in Reinstatement of Claims**
Northstar Educ. Fin., Inc. v. St. Paul Mercury Ins., et. al., 2013 Minn. App. Unpub. LEXIS 32 (Minn. App. 2013)	January	**Contract Exclusion Precludes Coverage for Other Claims Arising from Alleged Breach**
OneBeacon Am. Ins. Co. v. City of Granite City, 2013 U.S. Dist. Lexis 19475 (S.D. Ill. 2013)	February	**Damages under Liability Policy Do Not Include Restitution of Funds Wrongfully Taken**
OneBeacon Midwest Ins. Co. v. FDIC as Receiver for Habersham Bank, et al., 2013 U.S. Dist. LEXIS 44237 (N.D. Ga. 2013)	March	**Carrier's Suit Seeking Declaration of No Coverage Barred by FIRREA**
PCCP LLC v. Endurance Am. Spec, Ins. Co. 2013 U.S. Dist. LEXIS 114400 (N.D. Cal. 2013)	August	**No Coverage for Claim Made within Policy Period and Reported During Automatic Extended Reporting Period**
Pension Trust Fund for Operating Engineers v. Mortgage Asset Securitization Transactions, Inc. 2013 U.S. App. LEXIS 19166 (3rd Cir. 2013)	November	**Third Circuit Concludes "Discovery Rule" Triggers Statute of Limitations for 1933 Securities Act Claims**
Perini/Tompkins Joint Venture v. ACE Am. Ins. Co., 2013 U.S. App. LEXIS 24865 (4th Cir. 2013)	December	**Failure to Obtain Consent for Settlement under General Liability Policy Bars Coverage**
Progressive Cas. Ins. Co. v. FDIC, as receiver of Omni Nat'l Bank, et. al., 2013 U.S. Dist. LEXIS 28706 (N.D. Ga. 2013)	January	**Insured v. Insured Exclusion Inapplicable to FDIC Acting as Receiver**
Prosperity Mortg. Co. v. Certain Underwriters at Lloyd's, et al., 2013 U.S. Dist. LEXIS 98286 (D.Md. 2013)	July	**Court Rescinds E&O Policy Because Oral Suggestion to Settle a Potential Suit Not Disclosed on Policy Application**
Prot. Strategies, Inc. v. Starr Indem. & Liab. Co., Civil Action No. 1:13-CV-00763 (E.D. Va. 2013)	October	**Search and Seizure Warrant and Subpoena are Claims under D&O Policy**
Pyott v. Louisiana Mun. Policy Employees' Retirement Sys., et a., 2013 Del. LEXIS 179 (Del. 2013)	April	**Collateral Estoppel Doctrine Requires Dismissal of Delaware Derivative Action**
Quellos Group v. Fed. Ins. Co., 2013 Wash. App. LEXIS 2626 (Wash. App. 2013)	December	**Court Rules in Favor of Excess Insurers by Holding Exhaustion Language Unambiguous**

Case Cited	Month	Article Title
Regal-Pinnacle Integrations Indus., Inc. v. Phila. Indem. Ins. Co., 2013 U.S. Dist. LEXIS 56941 (D.N.J. 2013)	April	**Prior and Pending Litigation Exclusion and Interrelated Wrongful Act Provision Bar Coverage, but Insurer's Oral Representation to Fund a Settlement May Modify Insurance Contract**
Regency Title Co., LLC v. Westchester Fire Ins. Co., 2013 U.S. Dist. LEXIS 162772 (E.D. Tex. 2013)	December	**Regulatory Complaint Deemed a Claim under E&O Policy**
Reid v. Mercury Ins. Co., 2013 Cal. App. LEXIS 798 (Cal. App. 2013)	October	**Carrier Not Liable for Bad Faith Failure to Settle Where There Was No Settlement Demand from Claimant**
San Miguel Comm. Assoc. v. State Farm Gen. Ins. Co., 2013 Cal. App. LEXIS 836 (Cal. Ct. App. 2013)	December	**D&O Insurer Not Obligated to Defend Lawsuit Seeking Only Injunctive Relief**
Scottsdale Ins. Co. v. Coapt Sys., Inc., 2013 U.S. Dist. LEXIS 86414 (N.D. Ca. 2013)	June	**Narrow Wording of Professional Services Exclusion Saves Coverage**
Screen Actors Guild Inc. v. Fed. Ins. Co., et al., 2013 U.S. Dist. LEXIS 100638 (C.D. Cal. 2013)	July	**D&O Insurer Absolved of Obligation to Pay Fee Award When Underlying Claim Not Covered**
Secure Energy v. Phila. Indem. Ins. Co., 2013 U.S. Dist. LEXIS 69320 (E.D. Mo. 2013)	May	**Prejudice Requirement Held Inapplicable to Claims Made Policies**
Sirius XM Radio Inc. v. XL Spec. Ins. Co., et. al., 2013 N.Y. Misc. Lexis 5201 (N.Y. Sup. Ct. 2013)	December	**Notice of Potential Claim Sufficient to Trigger Coverage Obligations Based on Ambiguities in D&O Policy Language**
St. Paul Mercury Ins. Co. v. Miller, 2013 U.S. Dist. LEXIS 116877 (N.D. Ga. 2013)	August	**IvI Exclusion Bars Coverage for FDIC's Suit against a Failed Bank's Directors and Officers**
Standard. Mut. Ins. Co. v. Lay, 2013 Ill. 2013 Ill.LEXIS 564 (Ill. 2013)	May	**Telephone Consumer Protection Act Damages Are Insurable**
Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund, 2013 U.S. App. LEXIS 15190 (1st Cir. 2013)	August	**Private Equity Funds Potentially Liable for Pension Obligations of Portfolio Companies**
Syracuse Univ. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, No. 2012-EF-63 (Sup. Ct. Onondaga County 2013)	March	**Subpoenas Constitute "Claims" under Not-for-Profit D&O Policy**
Ticketmaster, LLC v. Ill. Union Ins. Co., 2013 U.S. App. LEXIS 8554 (9th Cir. 2013)	April	**Absent Proof an Exclusion is Only Susceptible to One Reasonable Interpretation, Dismissal of Coverage Action Improper**
Transched Sys. v. Fed. Ins. Co., 2013 U.S. Dist. LEXIS 108736 (D.R.I. 2013)	August	**Contract and Fraud Exclusions Found Inapplicable to Intentional Misrepresentation Verdict**
United States v. Vilar, 2013 U.S. App. LEXIS 1814 (2d Cir. 2013)	November	**Section 10(b) and Rule 10b-5 Do Not Govern Extraterritorial Conduct in Civil or Criminal Cases**
UnitedHealth Group Inc. v. Columbia Cas. Co., et al. 2013 U.S. Dist. LEXIS 59249 (D. Minn. 2013)	April	**Insured Has Burden of Proof on Allocation; Notice to Underwriting Insufficient**
Univ. of Texas Southwestern Medical Ctr. v. Nassar, 2013 U.S. LEXIS 4704 (2013)	June	**U.S. Supreme Court Makes Two Employer-Friendly Decisions under Title VII**
Universal Am. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 2013 N.Y. Misc. LEXIS 11 (N.Y. Sup. 2013)	October	**Denial of Coverage under Fidelity Bond Upheld Despite Broad Policy Language**
Vance v. Ball State Univ., 2013 U.S. LEXIS 4703 (2013)	June	**U.S. Supreme Court Makes Two Employer-Friendly Decisions under Title VII**
Western Heritage Bank v. Fed. Ins. Co., 2013 U.S. Dist. LEXIS (D.N.M. 2013)	April	**Court Broadly Interprets Bank's D&O Policy Lending Service "Arising Out Of" Language**
WMI Liquidating Trust v. XL Spec. Ins. Co., 2013 Del. Super. LEXIS 321 (Del. Super. Ct. 2013)	August	**Trustee Has Standing to Sue Carriers**
Zurich Am. Ins. Co. v. Diamond Title of Sarasota, Inc., et al., 2013 U.S. Dist. LEXIS 170981 (M.D. Fla. 2013)	December	**Carrier Entitled to Rescind E&O Policy Based on Misrepresentations in Application**

Shareholder Class Action Filings

Filing	Sector	Month	Jurisdiction
A123 Systems, Inc [2013]	Technology	September	S.D. New York
Accentia Biopharmaceuticals, Inc.	Healthcare	July	M.D. Florida
Accretive Health, Inc.	Services	May	N.D. Illinois
Achillion Pharmaceuticals, Inc	Healthcare	October	D. Connecticut
Active Power, Inc.	Industrial	September	W.D. Texas
Affymax, Inc.	Healthcare	February	N.D. California
Amarin Corporation plc	Healthcare	November	D. New Jersey
Amyris, Inc.	Basic Materials	May	N.D. California
Angie's List, Inc.	Technology	December	S.D. Indiana
ARIAD Pharmaceutical, Inc.	Healthcare	October	D. Massachusets
Aruba Networks, Inc.	Technology	May	N.D. California
Atlantic Power Corporation	Utilities	March	D. Massachusets
Atossa Genetics, Inc.	Healthcare	October	W.D. Washington
ATP Oil & Gas Corporation	Basic Materials	May	E.D. Louisiana
Autoliv, Inc.	Consumer Non-Cyclical	April	S.D. New York
AVEO Pharmaceuticals, Inc.	Healthcare	May	D. Massachusets
Avid Technology, Inc.	Technology	March	D. Massachusets
Bankrate, Inc. [2013]	Technology	October	S.D. New York
Barrick Gold Corporation	Basic Materials	June	S.D. New York
Biolase, Inc	Healthcare	August	C.D. California
BioScrip, Inc.	Healthcare	September	S.D. New York
BlackBerry Limited	Technology	October	S.D. New York
CafePress	Technology	August	N.D. California
Catalyst Pharmaceutical Partners, Inc.	Healthcare	October	S.D. Florida
CenturyLink, Inc.	Technology	June	S.D. New York
Cirrus Logic, Inc.	Technology	February	S.D. New York
Commonwealth Bankshares, Inc.	Financial	January	E.D. Virginia
Corinthian Colleges, Inc.	Services	June	S.D. New York
Deer Consumer Products, Inc.	Consumer Non-Cyclical	March	C.D. California
Delcath Systems, Inc.	Healthcare	May	S.D. New York
DFC Global Corp.	Financial	November	E.D. Pennsylvania
Digital Generation, Inc.	Services	May	N.D. Texas
Diodes, Inc.	Technology	March	E.D. Texas
Dynavax Technologies Corp.	Healthcare	June	N.D. California
ECOtality, Inc.	Industrial	August	N.D. California
Edwards LifeSciences Corp.	Healthcare	September	C.D. California
Electronic Arts, Inc	Technology	December	N.D. California
Electronic Game Card, Inc.	Services	January	S.D. New York
Energy Conversion Devices, Inc.	Services	June	N.D. California
Epocrates, Inc.	Technology	March	N.D. California
Exide Technologies	Basic Materials	April	C.D. California
Expedia, Inc. [2013]	Consumer cyclical	August	W.D. Washington
FAB Universal Corporation	Technology	November	S.D. New York
Family Dollar Stores, Inc.	Services	February	W.D. North Carolina
Francesca's Holdings Corp.	Services	September	S.D. New York
Furniture Brands International, Inc.	Consumer Non-cyclical	August	E.D. Missouri
Fusion-io, Inc.	Technology	November	N.D. California

Filing	Sector	Month	Jurisdiction
General Cable Corp [2013]	Industrial Goods	October	S.D. New York
Great Lakes Dredge & Dock Corporation	Industrial Goods	March	N.D. Illinois
Harvest Natural Resources, Inc.	Basic Materials	March	S.D. Texas
Hertz Global Holdings, inc.	Services	November	D. New Jersey
IEC Electronics Corp.	Technology	June	S.D. New York
iGATE Corporation	Technology	June	N.D. California
Impax Laboratories, Inc.	Healthcare	March	N.D. California
Incyte Corporation	Healthcare	March	D. Delaware
Inteliquent, Inc	Technology	August	N.D. Illinois
International Business Machines Corporation [2013]	Technology	December	S.D. New York
Intuitive Surgical, Inc.	Healthcare	April	N.D. California
Invacare Corporation	Healthcare	May	N.D. Ohio
ITT Educational Services, Inc.	Services	March	S.D. New York
Ixia	Technology	November	C.D. California
J.C. Penney Company, Inc.	Services	October	E.D. Texas
JAKKS Pacific, Inc. [2013]	Consumer cyclical	July	C.D. California
Juniper Networks, Inc. [2013]	Technology	August	N.D. California
Keryx Biopharmaceuticals, Inc.	Healthcare	February	S.D. New York
KiOR, Inc.	Basic Materials	August	S.D. Texas
Kohl's Corporation	Consumer cyclical	July	S.D. New York
L&L Energy, Inc.	Energy	September	S.D. New York
Liberty Silver Corp.	Basic Materials	September	S.D. Florida
LightInTheBox Holding, Co., Ltd.	Consumer cyclical	August	S.D. New York
Linn Energy, LLC	Energy	July	S.D. Texas
LinnCo, LLC	Energy	July	S.D. New York
Longwei Petroleum Investment Holdings Limited	Energy	January	N.D. California
Lululemon Athletica Inc.	Consumer cyclical	July	S.D. New York
Lumber Liquidators Holdings, inc.	Services	November	E.D. Virginia
Magnum Hunter Resources Corp.	Basic Materials	April	S.D. New York
majicJack VocalTec, Ltd.	Technology	January	C.D. California
Maxwell Technologies, Inc.	Technology	March	S.D. California
McDermott International, Inc. [2013]	Energy	August	S.D. Texas
Meadowbrook Insurance Group, Inc.	Financial	August	S.D. New York
Medtronic, Inc.	Healthcare	June	D. Minnesota
Mellanox Technologies, Ltd.	Technology	February	S.D. New York
Microsoft Corpoartion	Technology	August	D. Massachusets
MiMedx Group, Inc.	Healthcare	September	S.D. New York
Molycorp, Inc [2013]	Basic Materials	August	S.D. New York
MRI International, Inc.	Financial	July	D. Nevada
Nam Tai Electronics, Inc.	Technology	May	S.D. New York
Navistar International Corp.	Consumer Non-Cyclical	March	N.D. Illinois
Net 1 Ueps Technologies, Inc.	Services	December	S.D. New York
Netflix, Inc.	Services	February	N.D. California
NQ Mobile, Inc.	Technology	October	D. Massachusets
NuVasive, Inc.	Healthcare	August	S.D. California
Nuverra Environmental Solutions, inc.	Industrial	September	S.D. New York
Orthofix International N.V.	Healthcare	August	S.D. New York

Filing	Sector	Month	Jurisdiction
OSI Systems, Inc.	Industrial Goods	December	C.D. California
OvaScience, Inc.	Healthcare	September	D. Massachusets
PetroChina Company Ltd.	Basic Materials	September	S.D. New York
PhotoMedex, Inc.	Healthcare	November	E.D. Pennsylvania
Polycom, Inc.	Technology	July	N.D. California
Poseidon Concepts Corp.	Services	February	S.D. New York
Pretium Resources, Inc.	Technology	October	S.D. New York
Puda Coal, Inc.	Energy	April	S.D. New York
Quality Sustems, Inc [2013]	Technology	November	C.D. California
Raser Technologies, Inc.	Technology	February	D. Colorado
Sanofi	Healthcare	December	S.D. New York
Scuderi Group, Inc	Energy	June	D. Massachusets
SemiLEDs Corporation	Technology	July	S.D. New York
SFPC Holding Company, LLC	Services	April	N.D. Florida
Spectrum Pharmaceuticals, Inc.	Healthcare	March	D. Nevada
Spirit AeroSystems Holdings, Inc.	Industrial Goods	June	D. Kansas
Star Scientific, Inc.	Healthcare	March	E.D. Virginia
Tangoe, Inc.	Technology	March	D. Connecticut
Tellabs, Inc.	Technology	January	S.D. New York
Tesla Motors, Inc.	Consumer Goods	November	N.D. California
Tetra Tech, Inc	Services	June	C.D. California
TEVA Pharmaceutical Industries Limited	Healthcare	December	S.D. New York
The Bureau of National Affairs	Services	August	E.D. Virginia
The Cash Store Financial Services, Inc.	Financial	June	S.D. New York
The First Marblehead Corporation [2013]	Financial	August	D. Massachusets
The Phoenix Companies, Inc.	Financial	April	D. Connecticut
The Western union Company	Financial	December	D. Colorado
TierOne Corporation	Financial	January	N.D. Illinois
Tile Shop Holdings, Inc.	Services	November	S.D. New York
TNP Strategic Retail Trust, Inc.	Real Estate	September	C.D. California
Tower Group International, Ltd.	Financial	August	S.D. New York
Tremor Video, Inc	Technology	November	S.D. New York
Tri-Tech Holdings, Inc.	Industrial Goods	December	S.D. New York
Turquoise Hill Resources Ltd	Basic Materials	December	S.D. New York
Uni-Pixel, Inc.	Technology	June	S.D. New York
Unilife corporation	Healthcare	November	M.D. Pennsylvania
UniTek Global Services, Inc.	Services	April	E.D. Pennsylvania
Urban Outfitters, Inc.	Services	October	E.D. Pennsylvania
Uroplasty, Inc	Healthcare	July	S.D. New York
Valley Fordge Composite Technologies, Inc.	Industrial	September	S.D. California
ValueClick, Inc. [2013]	Technology	September	C.D. California
Vanda Pharmaceuticals, Inc	Healthcare	June	D. District of Columbia
Velti PLC	Technology	August	N.D. California
Ventrus Biosciences, Inc.	Healthcare	May	S.D. New York
VeriFone Systems, Inc.	Consumer Non-Cyclical	March	N.D. California
VeriSign, Inc.	Technology	January	D. Nebraska

Filing	Sector	Month	Jurisdiction
Vical	Healthcare	October	S.D. California
Violin Memory, Inc.	Technology	November	N.D. California
Vitamin Shoppe, Inc.	Services	May	D. New Jersey
Vocera Communications	Healthcare	August	N.D. California
Wal-Mart de Mexico SAB de CV	Services	April	S.D. New York
Walter Investment Management Corp.	Financial	July	M.D. Florida
Wyeth	Healthcare	April	S.D. New York
YPF Sociedad Anonima	Basic Materials	February	S.D. New York
YUM! Brands, Inc.	Services	January	E.D. Virginia

Shareholder Class Action Settlements

Case	Sector	Amount	Month	Jurisdiction
Accretive Health, Inc.	Services	$14,000,000	September	N.D. Illinois
Actrade Financial Technologies, Inc.	Financial	$5,250,000	March	S.D. New York
Adelphia Communications Corp.	Services	$12,000,000 [partial]	July	S.D. New York
Advanced Battery Technologies, Inc.	Industrial Goods	$275,000	December	S.D. New York
Aeropostale, Inc.	Services	$15,000,000	December	S.D. New York
American Int'l Group, Inc. [2004]	Financial	$72,000,000	June	S.D. New York
American Superconductor Corporation	Technology	$10,000,000	November	D. Massachusetts
Aracruz Celulose S.A.	Consumer Non-Cyclical	$37,500,000	January	S.D. Florida
Assisted Living Concepts, Inc. [2012]	Healthcare	$12,000,000	September	E.D. Wisconsin
Bidz.com, Inc.	Services	$3,150,000	March	C.D. California
Broadwind Energy, Inc.	Consumer Non-Cyclical	$3,915,000	March	N.D. Illinois
Caraco Pharmaceutical Laboratories, Ltd.	Healthcare	$2,975,000	February	E.D. Michigan
Career Education Corporation	Services	$27,500,000	October	N.D. Illinois
Carter's, Inc.	Consumer Goods	$3,300,000	June	N.D. Georgia
Chanticleer Holdings, Inc.	Services	$850,000	December	S.D. Florida
China Century Dragon Media, Inc.	Services	$778,333 [partial]	July	C.D. California
China Electric Motor, Inc.	Consumer Goods	$3,768,333	June	C.D. California
China Expert Technology, Inc.	Technology	$4,200,000	November	S.D. New York
China Medicine Corp.	Healthcare	$700,000	June	C.D. California
China North East Petroleum Holdings Ltd.	Energy	$2,500,000	August	S.D. New York
CIBER, Inc.	Technology	$3,000,000	December	D. Colorado
Citigroup Bonds	Financial	$730,000,000	March	S.D. New York
Computer Sciences Corp.	Technology	$97,500,000	May	E.D. Virginia
Constellation Energy Group, Inc. [2008]	Energy	$4,000,000	June	D. Maryland
Countrywide Financial Corp. [2010]	Financial	$500,000,000	April	C.D. California
Coventry Health Care, Inc.	Financial	$10,000,000	May	D. Maryland
Crocs, Inc.	Consumer Cyclical	$10,000,000 [partial]	September	D. Colorado
Dendreon Corp. [2011]	Healthcare	$40,000,000	March	W.D. Washington
DGSE Companies, Inc.	Services	$2,000,000	June	N.D. Texas
Diamond Foods, Inc.	Consumer Non-Cyclical	$11,000,000	August	N.D. California
Diebold, Inc. [2010]	Technology	$31,600,000	November	N.D. Ohio
Direxion Shares-EFT Trust	Financial	$8,000,000	February	S.D. New York
Duoyuan Global Water, Inc.	Capital Goods	$5,150,000	September	S.D. New York
Duoyuan Printing, Inc. [2010]	Capital Goods	$4,300,000	August	S.D. New York
Ener1, Inc.	Technology	$4,200,000	February	S.D. New York
FalconStor Software, Inc.	Technology	$5,000,000	January	E.D. New York
FalconStor Software, Inc.	Technology	$5,000,000	November	E.D. New York
FCStone Group, Inc. [2008]	Financial	$4,250,000	April	W.D. Missouri
Federal Nat'l Mortgage Assoc. [Fannie Mae]	Financial	$153,000,000	May	D. Columbia
Fushi Copperweld, Inc. [2011]	Basic Materials	$3,250,000	August	M.D. Tennesee
General Electric Co. [2009]	Conglomerates	$40,000,000	April	S.D. New York
Gulf Resoures, Inc.	Basic Materials	$2,125,000	August	C.D. California
Hansen Medical, Inc.	Healthcare	$4,250,000	August	N.D. California
Idearc, Inc.	Services	$33,750,000	June	N.D. Texas
Ikanos Communications, Inc.	Technology	$5,000,000	April	S.D. New York
Immucor, Inc. [2009]	Healthcare	$3,900,000	March	N.D. Georgia
Imperial Holdings, Inc.	Financial	$12,000,000	September	S.D. Florida

Case	Sector	Amount	Month	Jurisdiction
Internap Network Services Corp.	Technology	$9,500,000	August	N.D. Georgia
Johnson & Johnson [2010]	Healthcare	$22,900,000	July	D. New Jersey
K12, Inc.	Services	$6,750,000	March	E.D. Virginia
KIT Digital, Inc.	Technology	$6,000,000	June	S.D. New York
Lehman Brothers Holdings, Inc [Ernst & Young LLP]	Financial	$99,000,000	November	S.D. New York
Lehman Brothers Holdings, Inc. [Partial – UBS]	Financial	$120,000,000	October	S.D. New York
Lender Processing Services, Inc.	Services	$14,000,000	May	M.D. Florida
Lockheed Martin Corp. [2011]	Capital Goods	$19,500,000	February	S.D. New York
Matrixx Initiatives, Inc. [2009]	Healthcare	$4,500,000	January	D. Arizona
Merck & Co., Inc.	Healthcare	$215,000,000	February	D. New Jersey
NBTY, Inc.	Healthcare	$6,000,000	March	E.D. New York
Nomura Asset Acceptance Corp.	Financial	$21,200,000	August	D. Massachusetts
Novatel Wireless, Inc.	Technology	$16,000,000	December	S.D. California
OCZ Technology Group, Inc.	Technology	$7,500,000	October	N.D. California
Oilsands Quest, Inc.	Energy	$10,235,000	March	S.D. New York
Olympus Corp.	Consumer Cyclical	$2,603,500	September	E.D. Pennsylvania
Oppenheimer Rochester National Municipals Fund	Financial	$89,500,000 [partial]	August	D. Colorado
Pacific Biosciences of California, Inc.	Healthcare	$7,686,494	July	CA Superior Court, San Mateo County
Par Pharmaceutical Companies, Inc. [2006]	Healthcare	$8,100,000	February	D. New Jersey
Penson Worldwide, Inc.	Financial	$6,500,000	July	N.D. Texas
Perrigo Company	Healthcare	$1,787,500	March	S.D. New York
Radient Pharmaceuticals Corporation	Health Care	$2,500,000	December	C.D. California
Regions Morgan Keegan Funds	Financial	$62,000,000	January	W.D. Tennessee
Reserve Primary Fund	Financial	$54,500,000	October	S.D. New York
Residential Asset Securitization Trust 2006-A8	Capital Goods	$10,900,000	September	S.D. New York
Sanofi-Aventis	Healthcare	$40,000,000	September	S.D. New York
Schering-Plough Corp. [2008]	Healthcare	$473,000,000	February	D. New Jersey
Sequans Communications S.A.	Technology	$2,250,000	October	S.D. New York
Sigma Designs, Inc. [2011]	Technology	$550,000 [Partial]	April	S.D. New York
SinoTech Energy Ltd	Energy	$20,000,000	March	S.D. New York
SkyPeople Fruit Juice, Inc.	Consumer Non-Cyclical	$2,200,000	September	S.D. New York
Smart Technologies, Inc. [2011]	Technology	$15,250,000	May	S.D. New York
Smith Barney Mutual Funds	Financial	$4,950,000	July	S.D. New York
STEC, Inc. [2009]	Technology	$35,750,000	February	C.D. California
Suffolk Bancorp	Financial	$2,800,000	April	E.D. New York
Sunpower Corp.	Technology	$19,700,000	April	N.D. California
The Blackstone Group L.P.	Financial	$85,000,000	August	S.D. New York
UniTek Global Services	Services	$1,600,000	November	E.D. Pennsylvania
VeriFone Holdings, Inc.	Technology	$95,000,000	August	N.D. California
W. Holding Co., Inc.	Financial	$8,750,000	March	D. Puerto Rico
Winstar Communications, Inc.	Services	$10,000,000 [partial]	August	S.D. New York
Wonder Auto Technology, Inc.	Services	$3,000,000	January	S.D. New York
WorldSpace, Inc.	Services	$2,375,000	February	S.D. New York
ZST Digital Networks, Inc.	Technology	$1,700,000	April	C.D. California

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