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CAC Specialty™

CAC SPECIALTY NEWS & VIEWS

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LEGAL NEWS AND DEVELOPMENTS IN EXECUTIVE, EMPLOYMENT, FIDUCIARY, CRIME, AND CYBER LIABILITY

COVID-19'S EFFECTS ON DIRECTORS AND OFFICERS LIABILITY

As this document "goes to print," the United States and the entire world are feeling both the physical and financial impacts of COVID-19. CAC Specialty is closely monitoring the virus and the impacts it will continue to have on our clients' businesses, as well as the management and professional insurance marketplace as a whole. As our readers are no doubt aware, the personal and economic well-being of individuals and organizations across the globe is changing moment by moment. To that end, CAC Specialty is temporarily blogging updates regarding the virus' impact within the management and professional liability insurance marketplace. Please feel free to visit that blog often and leave any questions/comments you may have.

From a directors and officers liability perspective, we have already witnessed securities class actions related to the virus. On March 12, 2020, two separate securities class actions were filed.

The first claim is *Patrick McDermid, et al. v. Inovio Pharmaceuticals, Inc., et al*. This case was filed in the Eastern District of Pennsylvania and alleges the company and its CEO "….made false and misleading statements in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934…" Specifically, the plaintiffs allege that defendants claimed "…unequivocally that the Company had successfully developed a vaccine against the spread of COVID-19 and that it anticipated rapidly bringing that vaccine to market. Given the heightened anxiety surrounding this pandemic and the desperate demand for an effective COVID-19 vaccine, [d]efendants knew and were deliberately reckless as to the falsity of their claims…"

Citron Research published a message on March 9 stating that the "SEC should immediately HALT [Inovio's] stock and investigate the ludicrous and dangerous claim that they designed a vaccine in 3 hours…" The message led to a sell-off of Inovio stock and the securities class action at issue.

The second claim is *Eric Douglas, et al. v. Norwegian Cruise Lines, et al.* This case was filed in the Southern District of Florida and alleges that the company, its CEO and its CFO "…made false and/or misleading statements and/or failed to disclose that (1) the Company was employing sales tactics of providing customers with unproven and/or blatantly false statements about COVID-19 to entice customers to purchase cruises, thus endangering the lives of both their customers and crew members; and (2) as a result, Defendants' statements regarding the Company's business and operations were materially false and misleading and/or lacked a reasonable basis at all relevant times."

Beginning March 11, the Miami New Times (followed by the Washington Post) published articles quoting leaked emails indicating that Norwegian had pressured its sales personnel "…to lie to customers regarding COVID-19" to encourage company bookings.

We expect additional virus-related claims to be filed, and we will continue to keep you updated.

DELAWARE SUPREME COURT DECISION VALIDATING FEDERAL FORUM PROVISIONS IN CERTIFICATES OF INCORPORATION IS A WIN FOR ISSUERS AND THE D&O MARKETPLACE

On March 18, 2020, a very important decision was handed down in the Delaware Supreme Court. The case, *Matthew B. Salzburg et al. v. Matthew Sciabacucchi*, involved three companies (Blue Apron Holdings, Inc., Roku, Inc. and Stitch Fix, Inc.) which added Federal Forum Provisions (FFP) to their certificates of incorporation prior to filing their initial public offerings in 2017. Their FFPs provided that any Securities Act of 1933 claim (e.g. any Section 11 or related claim) must be brought in federal court. This provision was designed to eliminate the *Cyan* problem of litigating offering-related claims in both federal and state court.

A shareholder of the three companies petitioned the Delaware Court to hold that the FFPs were not valid under Delaware law. In December of 2018, the Delaware Court of Chancery found that FFPs were, in fact, invalid. Specifically, "(t)he court decided that the 'constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law. Because 'the Federal Forum Provisions attempt to accomplish that feat,' the court held that the Federal Forum Provisions are 'ineffective and invalid.'"

After a lengthy discussion of Delaware corporate law, the Supreme Court reversed that decision, concluding:

"FFPs are a relatively recent phenomenon designed to address the post-Cyan difficulties presented by multiforum litigation of Securities Act claims. The policies underlying the DGCL (Delaware General Corporation Law) include certainty and predictability, uniformity, and prompt judicial resolution to corporate disputes. Our law strives to enhance flexibility in order to engage in private ordering, and to defer case-by-case law development. Delaware courts attempt 'to achieve judicial economy and avoid duplicative efforts among courts in resolving disputes.' FFPs advance these goals. Our General Assembly has also recognized the need to maintain balance, efficiency, fairness, and predictability in protecting the legitimate interest of all stakeholders, and to ensure that the laws do not impose unnecessary costs on Delaware entities. FFPs do not violate that sense of balance as they allow for litigation of federal Securities Act claims in a federal court of plaintiff's choosing, but also allow for consolidation and coordination of such claims to avoid inefficiencies and unnecessary costs.

Finally, our DGCL was intended to provide directors and stockholders with flexibility and wide discretion for private ordering and adapting to new situations. '[T]hat a board's action might involve a new use of plain statutory authority does not make it invalid under our law, and boards of Delaware corporations have flexibility to respond to changing dynamics in ways that are authorized by our statutory law.'"

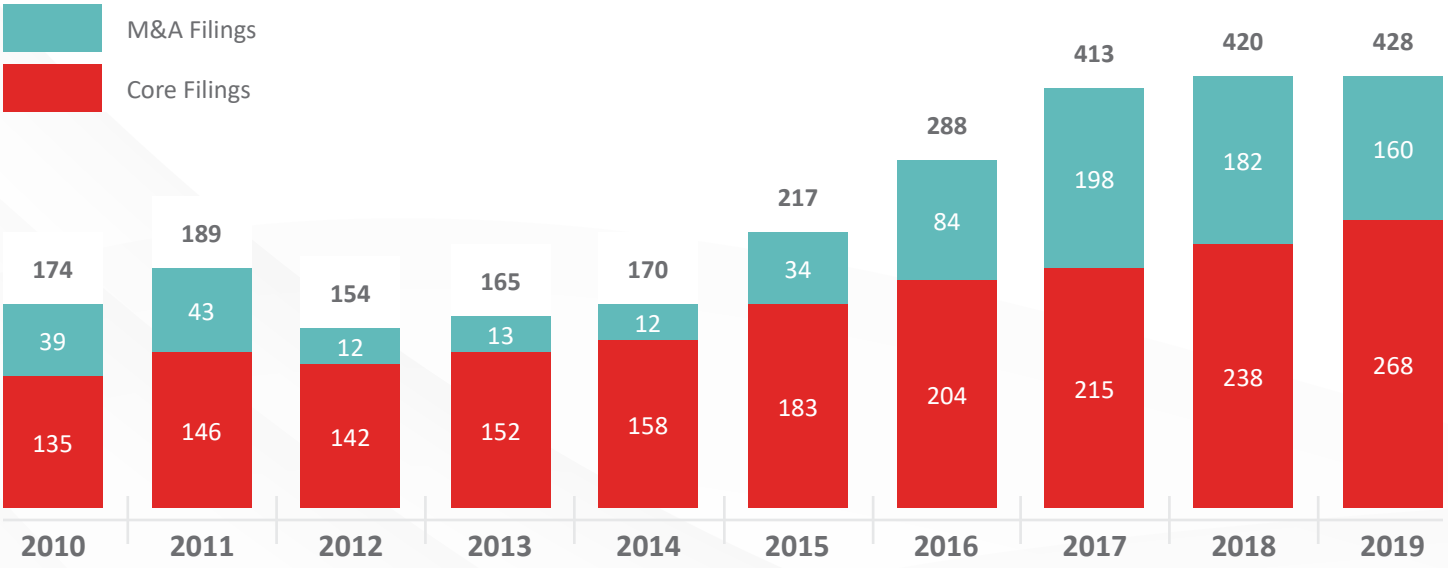
WHAT DOES THIS MEAN?

Given the significant litigation exposure '33 Act filers face, this is a win for public companies incorporated in Delaware. It is important to note that many insurers have been pursuing legislative reform around the *Cyan* decision. Therefore, it will be interesting to see if this decision is viewed as meaningful change by the insurance marketplace or just a step in the direction of reform.

2019 IN REVIEW:
INCREASE IN SECURITIES CLASS ACTIONS AND STATE '33 ACT CLAIMS

According to Cornerstone Research's *2019 Securities Class Actions Year in Review*, the annual number of new securities class action filings increased slightly in 2019, while core filings (i.e. non-M&A related) reached record levels. 2019 witnessed 428 new class action securities filings, 268 of which were core filings, representing a 13% increase over the number of core filings in 2018. Meanwhile, the number of 2019 M&A filings (160) decreased slightly from 2017 and 2018, during which 198 and 182 M&A actions were filed.

ANNUAL SECURITIES CLASS ACTION FILINGS*
2010 - 2019



Note: This figure begins including state 1933 Act filings in the annual counts in 2010. Parallel class actions are only reflected as a single filing.
*Source: Cornerstone Research *2019 Securities Class Actions Year in Review*

Following the U.S. Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, in which the Court ruled that state courts retain concurrent jurisdiction for Securities Act of 1933 ("33 Act") liability, state actions alleging 33 Act violations rose by 40% from 2018 to 2019. In fact, state court filings involving 33 Act claims surpassed those filed in federal courts, particularly in New York, which is becoming the favored state venue for plaintiffs.

An additional trend that has emerged post-*Cyan* is the frequency of parallel state and federal actions asserting overlapping securities claims. In 2019, approximately 45% of all state 33 Act claims had a parallel action filed in federal court.

These trends are concerning to D&O underwriters for several reasons. First, there is a significant degree of uncertainty surrounding how non-expert state courts, inundated with the typical disputes to which they are → *continued on next page*

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accustomed, will adjudicate complex federal securities claims. While securities claims under Section 10(b) of the '34 Act require proof of intentional misconduct, stringent pleading requirements, and a stay of discovery, IPO-related claims under the '33 Act impose liability for unintentional or simply negligent misstatements. It remains to be seen whether state courts across the country will observe and apply the heightened pleading standards under the Private Securities Litigation Reform Act (PSLRA), or instead subject defendants to arduous discovery before a motion to dismiss is decided.

Ultimately, if state and federal courts fail to follow the same procedural rules and standards for the adjudication of securities claims, we can expect to see higher than average defense fees in state court actions that are not dismissed at the same rate as their federal equivalents. On the other hand, parallel actions may also lead to quicker and smaller settlements by plaintiffs who are concerned about the risk of collateral estoppel from other proceedings.

Another concern is the potential for double plaintiffs' attorney fee awards in parallel actions filed in state and federal court. While the plaintiff can only recover damages in one jurisdiction, insurers are understandably concerned that fee awards may be much greater than anticipated with two venues involved.

However, as noted above, the Delaware Supreme Court's recent decision in *Matthew B. Salzburg et al. v. Matthew Sciabacucchi* is expected to curtail this concern for Delaware companies that include Federal Forum Provisions (FFP) in their certificates of incorporation prior to filing their initial public offerings.

ANNUAL SECURITIES CLASS ACTION SETTLEMENTS*
1996 - 2019

(Dollars in Millions)	1996 - 2018	2018	2019
Number of Settlements	1,775	78	74
Total Amount	$103,955.60	$5,154.80	$2,029.90
Minimum	$0.20	$0.40	$0.50
Median	$8.80	$11.50	$11.50
Average	$58.80	$66.10	$27.4
Maximum	$9,172.10	$3,054.40	$389.6

Note: Settlement dollars are adjusted for inflation; 2019 dollar equivalent figures are used. Chart includes all post-Reform Act settlements. Settlements in prior years have included 14 cases exceeding $1 billion. Adjusted for inflation, these settlements drive up the average settlement amount.
*Source: Cornerstone Research *2019 Review and Analysis of Securities Class Action Settlements*

Settlements continued at historically high levels in 2019 as well. According to *Cornerstone Research's 2019 Review and Analysis of Securities Class Action Settlements*, these settlement amounts were "driven by an increase in the overall percentage of mid-sized cases in the $5 million to $25 million range as well as a decrease in the number of smaller settlements." 2019 witnessed 74 settlements totaling $2 billion, along with four mega-settlements of $100 million or higher. Although the median settlement amount in 2019 remained similar to the 2018 median, the 2019 median was 34% greater than the prior nine-year median. However, the average 2019 settlement amount of $27.4 million was 43% lower than the prior nine-year average.

CAC Specialty will continue to monitor and report on trends and developments in state and federal securities class action filings and settlements throughout the year.

CALIFORNIA COURT OF APPEAL:

WAGE AND HOUR EXCLUSION DOES NOT APPLY TO INSURED'S ALLEGED FAILURE TO REIMBURSE BUSINESS EXPENSES

As many insureds have learned the hard way, off-the-shelf employment practices liability policies expressly exclude coverage for allegations involving wage, hour, and overtime laws (e.g. violations of the Fair Labor Standards Act). This is a particularly difficult risk to insurers due to the moral hazard of insuring companies that may attempt to shift their payroll obligations to their insurers. While coverage for this particular exposure is available via offshore standalone policies offering both indemnity and defense cost coverage, sub-limited coverage, limited to defense costs only, is also available in the United States via endorsements to standard employment practices policies. These sub-limits are typically quite low in comparison to the average costs associated with defending and resolving wage and hour class actions.

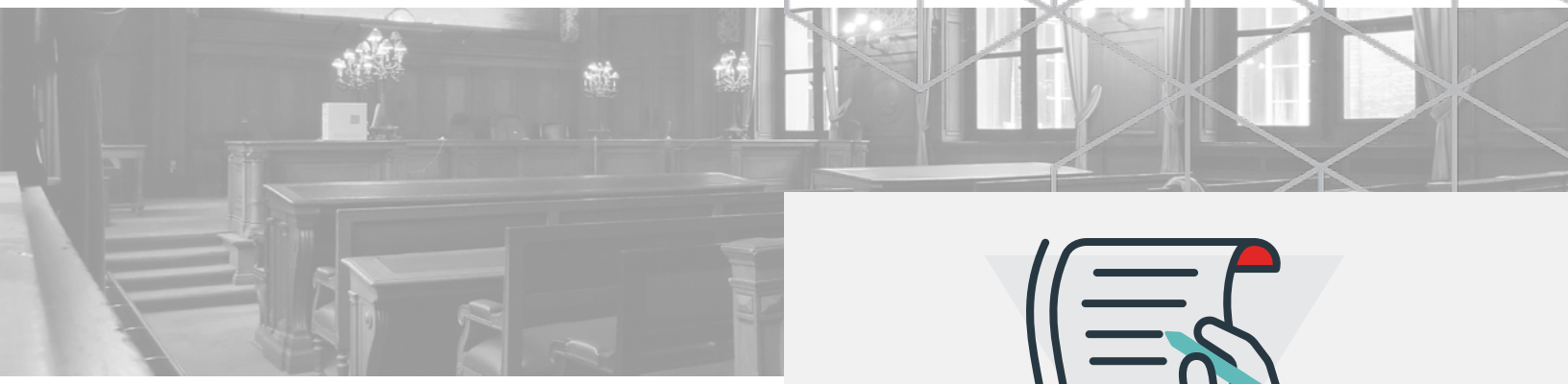
Insurers tend to broadly apply wage and hour exclusions to any allegations that even remotely involve or reference state labor codes. However, in *S. Cal. Pizza Co., LLC v. Certain Underwriters at Lloyd's London Subscribing to Policy No. 11EPL-20208*, a recent decision by the California Court of Appeal provides for potential coverage for insureds accused of failing to reimburse employees for business-related expenses. As discussed in greater detail below, the court held that the undefined term "wage and hour … law" in the context of an insurance exclusion is limited only to laws "concerning duration worked and/or remuneration received in exchange for work," and business-related expenses do not constitute "payments made in exchange for labor or services." Therefore, if your company is the subject of litigation involving the reimbursement of expenses or relief outside of "remuneration received in exchange for work," please consult your broker and consider reporting such matters to your employment practices liability insurers.

THE COURT'S DECISION

After seeking coverage from its employment practices liability insurer for a class action lawsuit alleging various violations of the California Labor Code, the insured received a declination letter citing the policy's wage and hour exclusion, which precluded coverage for claims "based upon, arising out of, directly or indirectly connected or related to, or in any way alleging violation(s) of any foreign, federal, state, or local, wage and hour or overtime law(s)[.]"

Coverage litigation ensued, and the trial court ruled in favor of the insurer, finding the wage and hour exclusion precluded coverage in its entirety. On appeal, the trial court's decision was reversed, and the Court of Appeal found that certain labor code provisions cited in the class action did not represent "wage and hour laws" and thus did not fall within the policy's exclusion. Specifically, the Court found the term "wage and hour laws" refers to laws "concerning duration worked and/or remuneration received in exchange for work." Therefore, an allegation that the insured failed to reimburse its employees' business-related expenses does not constitute a "wage and hour law" because "[d]isbursements for losses and work related expenditures are not payments made in exchange for labor or services."

The Court of Appeal focused its analysis on the policy's grant of coverage for "any … employment related workplace tort," finding it determinative of the issue. "Here, the wrong alleged (failure to reimburse business expenses) is not grounded in the breach of a contract, and the Legislature enacted a statute which gives the injured party (an employee) a remedy against the wrongdoer (an employer). Our conclusion is supported by the fundamental aim of the relevant statutes."



EQUIFAX SETTLES BREACH-RELATED SECURITIES CLASS ACTION FOR $149M

Event-driven securities class actions, particularly those filed following data breaches, continue to increase in frequency. Upon disclosure of a new data breach, it is not uncommon for plaintiffs' firms to immediately issue press releases to begin trolling for shareholders on whose behalf they may sue the affected company. In many cases, breach-related shareholder lawsuits have not been particularly successful. However, Equifax recently agreed to pay a record $149 million to settle its cybersecurity-related securities class action, along with $32.5 million to be funded by its insurers to settle derivative litigation also related to the breach.

Unprecedented in both scope and severity, Equifax's massive security breach compromised the personally identifiable information of over 140M Americans. In the days following the company's disclosure of the breach, Equifax's stock dropped a total of over 35%. As a result of the stock drop, a securities class action styled *In re Equifax Inc. Securities Litigation* was filed by Equifax's shareholders alleging, among other things, that the company and its executives made material misrepresentations in the company's public filings and failed to promptly provide the public with information about the breach. Specifically, the shareholder alleged "the defendants made multiple misleading statements and omissions about the sensitive information in Equifax's custody; about the vulnerability of the company's systems to cyber attack; and about the company's compliance with data protection laws." Despite these assurances, the shareholder alleged Equifax "failed to take the most basic precautions to protect systems from hackers."

Equifax is one of the largest credit monitoring companies in the United States. The information the company collects to perform its services includes the names, addresses, birth dates, drivers' license information and social security numbers of its customers. On July 29, 2017, Equifax discovered its computer system had been compromised. According to the company's press release, Equifax then hired a cybersecurity firm to conduct "…a comprehensive forensic review to determine the scope of the intrusion, including the specific data impacted." Equifax did not disclose the breach to the public until September 7, 2017. Between the time the company realized their system had been compromised and disclosure of the breach, three executives sold company stock worth close to $2M.

Although this is the largest breach-related securities class action settlement to date, it is important to remember that most breaches do not result in a securities class action that withstands a motion to dismiss. The facts in this case, and in the Yahoo class action which settled for $80M, were unique. In both cases, the companies failed to disclose the breach in an expedient manner, and the damages associated with the cases were both quantifiable and significant. As mentioned above, the value of Equifax's stock dropped over 35% following disclosure of the breach. Yahoo's breach was disclosed during the time it was being purchased by Verizon, and the purchase price was adjusted downward as a result of disclosure.

CAC Specialty will continue to monitor the larger breach-related securities class actions in the pipeline.

CAC Specialty™

Expanding what's possible for solving risk challenges – from the simple to the previously unsolvable.

ABOUT CAC SPECIALTY

CAC Specialty is a risk solutions company of seasoned and proactive senior industry leaders, operating as a nimble and collaborative partner who puts you and your business first. With a knowledge-driven approach informed by data and decades of honed instinct, CAC Specialty brings an innovative vision to insurance broking and structured solutions to solve your risk challenges – from the simple to the previously unsolvable.

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