IMA

EXECUTIVE RISK SOLUTIONS

OCTOBER 2024

Quarterly Update

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CASES OF INTEREST

+ *Securities Class Action and Derivative Suit Containing Different Allegations Both Afforded Covered*

As an addendum to the cases highlighted in our April 2024 Newsletter regarding inter-related claims and "specific litigation" exclusions, the Under Armour coverage litigation before the U.S. District Court for Maryland warrants its own case summary. In 2017, securities class actions were filed against the insureds alleging overly optimistic and false revenue projections, among other things. In June and July of 2018, three derivative lawsuits were filed against the insureds, following several derivative demands that dated back to 2016. The SEC then issued Wells Notices in 2020 and an Order in 2021 (after several years of investigation) charging the insureds with misleading investors about its revenue prospects and failing to disclose known uncertainties regarding future revenue. A $9 million civil penalty was paid to resolve the SEC matter.

Notice of the securities class actions was provided under the insured's 2016-2017 D&O program, while the derivative claims and SEC investigation were noticed under the 2017-2018 D&O program. The primary insurer in the 2017-2018 program took the position that all of the above matters involved the same Wrongful Acts or Interrelated Wrongful Acts, meaning coverage was not available under the 2017-2018 D&O program. This latter program also included a Specific Litigation exclusion listing the securities class actions and derivative demands (all of which pre-dated the 2017-2018 policy period), along with a Prior Notice exclusion.

The insurers filed a declaratory judgment action seeking judicial confirmation that coverage did not attach under the 2017-2018 program. The court ultimately found that coverage attached under both programs. "While this Court recognizes that the class action plaintiffs considered the findings from the governmental investigations to be useful evidence in their case, the claims involve different parties, focus on overlapping, but not identical, time periods, raise different theories of liability, rely on different evidence, and seek different relief." The court relied on the same reasoning to find the Specific Litigation and Prior Notice exclusions inapplicable.

This case represents another example of courts interpreting policy provisions in a very different manner than may have been intended by the underwriters and brokers. Here, a Single Claims provision in the policies ended up being what preserved coverage under an entire separate program of insurance. Challenging insurers to justify denials and even forcing them to litigate the issue when policy provisions are not entirely clear on a topic can benefit policyholders, as these cases indicate. A thorough discussion with an insured's broker and counsel is always a good idea when assessing which policies may afford coverage for a particular case. *Endurance American Insurance Co. v. Under Armour, Inc.*, 2024 WL 1640565 (D. Md. April 15, 2024).

SPAC Shareholders Lack Standing to Sue Over Pre-Merger Statements by Target Company

During the height of the SPAC frenzy of 2020-2021, Churchill Capital Corporation IV (CCIV) agreed to acquire Lucid Motors, a private company. Merger negotiations occurred between January 11, 2021 and February 22, 2021. During that time, the CEO of Lucid represented that 6,000-7,000 units were expected to be completed in 2021. He further claimed that the cars were ready for production and should be available in the Spring of 2021. Subsequently, on the day the merger was announced, Lucid publicly disclosed it actually only expected 577 vehicles to be produced in 2021.

CCIV shareholders filed suit, alleging violations of the Exchange Act Sections 10(b), 20(a) and SEC rule 10b-5. Defendants moved to dismiss the Complaint on the basis that the alleged misrepresentations were not material. The federal district court found claimants possessed standing, holding the defendant's purported misrepresentations did affect the SPAC securities. On appeal to the Ninth Circuit Court of Appeals, the lower court's ruling regarding standing was reversed and the case dismissed.

The Ninth Circuit panel adopted the reasoning employed by the Second Circuit in *Menora Mivtachim Ins. Ltd. V Frutarom Indus. Ltd.*, 54 F.4th 88, (2d Cir. 2022).

"[P]urchasers of a security of an acquiring company do not have standing under Section 10(b) to sue the target company for alleged misstatements the target company made about itself prior to the merger between the two companies." The purchaser-seller or, "Birnbaum Rule", confines standing to the purchasers or sellers of the stock in question. The appellate court found claimant's position on standing unworkable, requiring courts to determine whether the security purchased was sufficiently connected to the misstatements made by a company other than the issuer. "Plaintiffs 'sufficiently connected' test is anything but a bright-line rule and would require an extensive qualitative analysis by a court at the outset of a securities action."

With the Second and Ninth Circuits being the two primary jurisdictions in which the majority of securities class actions are filed, it will be interesting to see if plaintiff firms looking to advance this theory of liability will have better luck elsewhere. *In re: CCIV/Lucid Motors Securities Litigation*, 110 F.4th 1181 (9th Cir. August 8, 2024).

+ *Broad Indemnification Obligations Upheld Against Former Employer*

After two former employees were sued for misappropriation of trade secrets and breach of non-compete agreements, they demanded indemnification from the former employer suing them. As you might expect, their demands were refused, and they were forced to litigate the dispute. The Delaware Court of Chancery looked to the former employer, Unisys, Inc.'s Articles of Incorporation and Bylaws to determine whether indemnification was warranted. Unisys asserted the former employees were not directors or officers entitled to indemnification.

Noting that Delaware policy supports the approach of resolving ambiguity in favor of indemnification and advancement, the court found the refusal by Unisys to be in derogation of contractual obligations set forth in their governing documents. "Under Delaware law, the 'by reason of the fact' standard, or the official capacity standard, is interpreted broadly and in favor of indemnification and advancement. The inquiry is not focused on when the individual seeking advancement allegedly misused the information; rather, the court looks to when and in what capacity they originally acquired it."

Based on the evidence presented, the court agreed the claims being asserted against the former employees were by reason of their service at Unisys subsidiaries. The court concluded the opinion by reminding the parties that no Delaware corporation is required to provide for advancement of expenses and that when one does, it has broad powers and flexibility to tailor advancement to its needs. "When a corporation mandates advancement to the full extent of what is permissible under the statute, it must honor the attendant obligations that flow from that decision."

As such, the former employees were entitled to advancement of the approximately $4.5 million in legal fees incurred in defending the claims brought by Unisys. In addition, the former employees were awarded the fees incurred in litigating their right to advancement. *Gilbert, et. al. v. Unisys Corporation*, 2024 WL 3789952 (Del. Ch. August 13, 2024).

Derivative Cases Involving Parallel Suits or SEC Actions More Likely to Include Monetary Settlement

Cornerstone Research recently issued a study analyzing the settlements of shareholder derivative cases that involved conduct also being challenged in a federal securities class action. The authors note that 47% of securities class action settlements between 2019 and 2023 were accompanied by parallel shareholder derivative actions. They noted a 36% premium for cases with an accompanying derivative suit. Of the 110 parallel derivative settlements, only 26% included a monetary component. "Overall, derivative settlements with a monetary component are associated with higher securities class action settlements, consistent with the view that the monetary settlements correlate with the size of the case or the strength of the underlying allegations." Similarly, derivative settlements with a monetary component were found more likely to be associated with an SEC action or criminal charges against the defendants or related parties. These findings are hardly a surprise for practitioners in this field. With an ever-growing stable of plaintiffs' firms looking to make a name for themselves, follow-on derivative suits appears to now be the norm.

Professional Services Exclusion Bars D&O Coverage in Anti-Trust Litigation

A property management firm facing anti-trust litigation filed by the Department of Justice will not be afforded coverage under its D&O insurance by reason of a Professional Services exclusion. Windsor Property Management was named as a defendant for its use of RealPage software in setting lease prices. The D&O program included a primary policy and two excess policies that follow form, meaning they adopt the terms of the primary policy unless otherwise noted. The primary policy contained a Professional Services exclusion that removed coverage on account of any claim based upon, arising from, or in consequence of performing or the failure to perform any professional service.

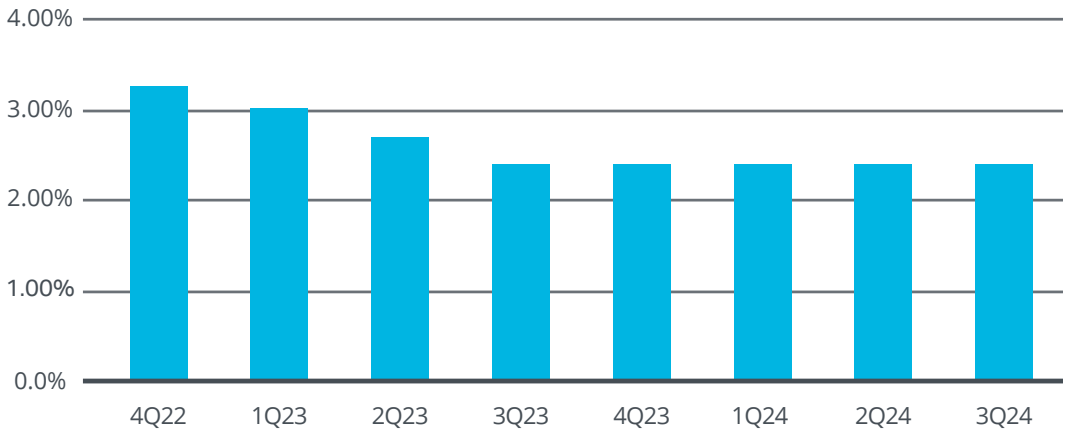
The primary policy also specified the Insured retained the right to select defense counsel, thereby affirming the insurer did not possess a duty to defend. In rejecting Windsor's arguments, the court noted they hinge on the assumption that the primary policy encompassed a duty to defend, such that a 'potential coverage' standard applied despite clear language to the contrary. Relying on both the Professional Services exclusion and the "duty to defend" language in the policy, the court agreed with the insurers that no coverage was afforded under the primary or excess policies. *Argonaut Insurance Co. v. GID Investment Advisers Corp.*, 2024 WL 4069028 (D. Mass. September 5, 2024).

TRANSACTIONAL LIABILITY INSURANCE UPDATE

Reps & Warranties

+ After several consecutive quarters of declining pricing, we began to see a fair amount of rate stabilization beginning in the second half of 2023. While certain underwriters are quoting rates near 2% "rate on line" (i.e., pricing as a percentage of limit), in general pricing seems to have plateaued around 2.4%.

Average Reps & Warranties Pricing as a Percentage of Limit
(4Q2022 to 3Q2024)



+ We continue to see interest in excess fundamental reps-only coverage, as well as excess fundamental reps & tax-only coverage with rates in the 1% range.

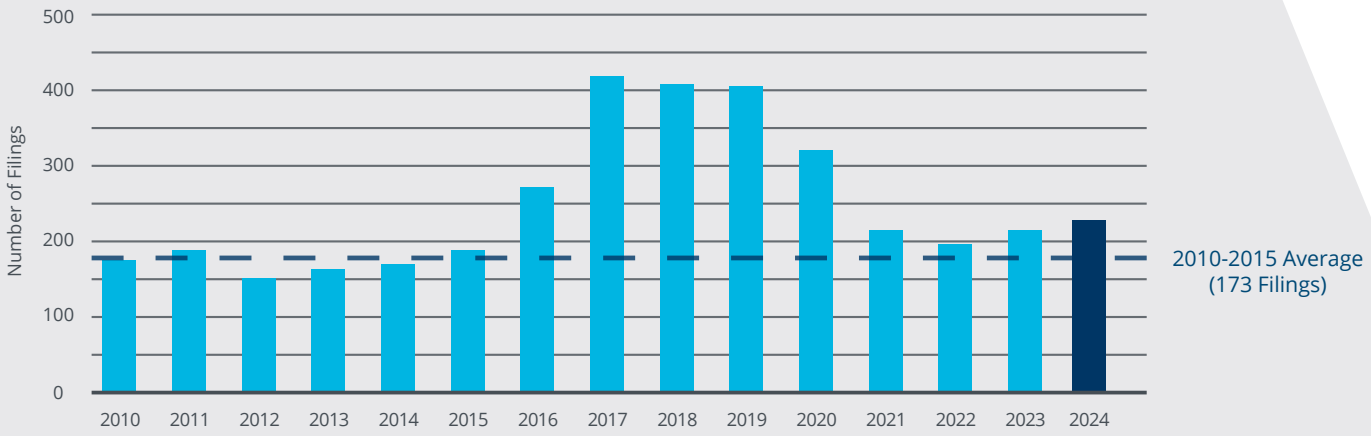
+ Claims data continue to indicate that 1 in 5 (20%) of RWI policies placed result in a notice of claim.

+ Leading types of rep breaches includes: (1) financial statements/accounting, (2) compliance with laws, (3) tax, and (4) employment.

D&O Filings

+ As we have previously reported, D&O Federal Securities Class Action Claims decreased noticeably from 2019-2022.
+ In 2023, however, filings *increased* for the first time in six years, with 213 total Federal Securities Class Action Claims.
+ Filing rates through September 2024 imply an annualized number of 227 Federal Securities Class Action Claims.
  – This would represent a year-over-year *increase* of 6.6%, resulting in two consecutive years of increases.

Federal Securities Class Action Filings
(2010-2024)



Note. Data from IMA proprietary database.
*2024 full year estimate based on actual filings through September (170)

D&O PRICING AND OUTLOOK

+ Although D&O litigation (and SEC filings) increased in 2023 and is on track to increase again in 2024, overall market conditions have remained favorable through the first three quarters of the year. D&O pricing for recent renewals has generally been more favorable than year ago levels. In limited instances, we have also seen carriers incrementally *increase* their limit deployment.
+ We do continue to pay close attention to recent litigation trends along with D&O carrier performance and the impact both may have on the marketplace. *Many D&O carriers and reinsurers have publicly stated that current rates are not sustainable.*
+ It should be noted that carriers remain more cautious regarding companies that need to raise capital in the near-term.
+ As we look forward over the remainder of 2024, we are optimistic that current trends will continue to hold, with incremental pricing improvement and stable capital deployment.

Sources: Cornerstone Research; Stanford Law School; IMA proprietary database

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