EXECUTIVE RISK SOLUTIONS
Q1 2018 UPDATE

CASES OF INTEREST

- U.S. SUPREME COURT FINDS STATE COURTS RETAIN JURISDICTION OVER 1933 ACT CLAIMS
- STATUTORY DAMAGES FOR VIOLATION OF TCPA FOUND TO BE PENALTIES AND UNINSURABLE UNDER COLORADO LAW
- COURT REFUSES TO APPROVE OBJECTION CASE THAT DID NOT BENEFIT SHAREHOLDERS
- SPECIFIC LITIGATION EXCLUSION DOES NOT BAR COVERAGE FOR SUBSEQUENT LAWSUIT DESPITE OVERLAPPING FACTS

D&O FILINGS, SETTLEMENTS AND OTHER DEVELOPMENTS

CASES OF INTEREST

U.S. SUPREME COURT FINDS STATE COURTS RETAIN JURISDICTION OVER 1933 ACT CLAIMS

In a highly anticipated decision regarding whether securities suits only asserting violations of the Securities Act of 1933 can be brought in state court, the U.S. Supreme Court upheld state court jurisdiction, meaning that 1933 Act claims may be brought in either state or federal court, and that state court actions are not removable to federal court.

The Securities Act of 1933 created a private right of action for investors in an offering, in either state or federal court. In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), amending the 1933 Act. However, important procedural protections (for issuers) included in the PSLRA were only applicable to federal court cases. As a result, plaintiffs began filing state court claims in order to circumvent the unfavorable procedural requirements.

Three years later, in 1998, Congress passed the Securities Litigation Reform Uniform Standards Act (SLUSA) to address the unintended consequence of limiting procedural requirements to federal court actions, and to create uniformity in the treatment of securities class action claims.

Subsequent to the enactment of this legislation, questions remained over whether SLUSA pre-empted the 1933 Act, which explicitly allows for concurrent state court jurisdiction over 1933 Act claims.

In its unanimous opinion, the U.S. Supreme Court found that SLUSA did nothing to strip state courts of their longstanding jurisdiction, thereby providing the plaintiff's bar with a victory. This resolves a split among circuit courts that had issued conflicting decisions. It is an important victory for plaintiffs, who had preferred bringing 1933 Act claims in state court, because of their lower dismissal rates and procedural hurdles as compared to federal court. For instance, federal courts prevent discovery being conducted until a Motion to Dismiss has been decided, whereas discovery can begin much earlier in state courts. As a result, defense costs in state courts have the potential for being significantly higher at the outset and prompting early settlement even if the allegations are frivolous.

The consequences of this ruling are that corporate defendants are now likely to see more 1933 Act cases filed in state court, along with the possibility of having to litigate securities claims in multiple jurisdictions (i.e., state court and federal court, or even multiple state courts). Plaintiffs have three years from the offering date to bring a 1933 Act claim, and one year from inquiry notice of a claim. In these claims, defendants will not be afforded the procedural protections applicable to cases filed in federal court.

It will be interesting to see if Congress chooses to amend the SLUSA as a result of this decision, or if companies will amend corporate bylaws to require federal court as the exclusive forum for bringing securities class action claims. Needless to say, this is likely not the last word on the issues addressed in this case.

Cyan, Inc. v. Beaver County Employees Retirement Fund, et. al., 583 U.S. ___, 138 S.Ct. 1061 (2018).

STATUTORY DAMAGES FOR VIOLATION OF TCPA FOUND TO BE PENALTIES AND UNINSURABLE UNDER COLORADO LAW

Following the denial of coverage for both defense and indemnity in a lawsuit alleging violations of the Telephone Consumer Protection Act (TCPA), an insurer filed a declaratory judgment action seeking a determination of its obligations under a commercial general liability policy.

The central issue before the court was whether the statutory damages and injunctive relief set forth in the statute constitute uninsurable penalties under Colorado law.

The insurer originally accepted coverage under the 'personal and advertising injury' section of the policy, but subsequently reversed its position, asserting that the statutory damages were uninsurable penalties and the injunctive relief sought did not qualify as damages under the policy.

The trial court found in favor of the insurer and the judgment was affirmed on appeal.

The appellate court went into a lengthy discussion of Colorado public policy regarding whether statutory damages are penal in nature and their insurability, concluding that even if the policies afforded coverage for such damages, Colorado public policy prohibits such penalties from being insured. "Colorado courts focus on the precise TCPA remedy sought by the plaintiff, and where that claim is for statutory damages, the TCPA is treated as penal under Colorado law…In sum, the provision awarding statutory damages for violating the TCPA is a penalty under Colorado law and uninsurable as a matter of Colorado public policy."

As such, the insurer did not owe the insured a defense or indemnity coverage.

ACE American Insurance Co. v. Dish Network, LLC, 883 F.3d 881 (10th Cir. 2018).

COURT REFUSES TO APPROVE OBJECTION CASE THAT DID NOT BENEFIT SHAREHOLDERS

This case represents an interesting back and forth between a New York trial court and appellate court over the merits of merger objection lawsuits that are settled following the disclosure of additional information without any financial benefit to shareholders.

In rebuking the appellate court's conclusions, the trial court again refused to approve the settlement agreed to by the litigants and accused the appellate court of allowing New York courts to be last forum where frivolous merger objection cases could be filed and settlements only benefiting the attorneys approved.

Following the announcement of the acquisition of Texas Industries, Inc., shareholders brought suit alleging material misstatements and omissions in the proxy statement provided in advance of the vote on the transaction. Additional disclosures were subsequently provided to shareholders in conjunction with the suit and a settlement was negotiated to resolve the case.

Finding the disclosures provided no material benefit to shareholders, the trial court rejected the settlement. On appeal, the appellate court chastised the trial court and ordered a fairness hearing be held regarding the proposed settlement.

On remand, the trial court went into a lengthy review of New York and Delaware law on whether the claims asserted in the lawsuit were meritorious and warranted a fee award to plaintiff's counsel.

"In other words, approval requires a clear showing that the supplemental disclosures were more than 'arguably beneficial' or that they may provide some benefit. Rather, it must be clear that the new disclosures would clearly aid shareholders in deciding whether to vote on the merger by significantly altering the 'total mix' of available information."

After a detailed analysis of the supplemental disclosures, the court found them utterly useless to shareholders and again rejected the proposed $500,000 fee award to plaintiff's counsel.

While this decision may also be appealed, it is in line with other courts throughout the nation that are no longer rubber-stamping merger objection cases that provide a substantial payday for the lawyers involved while only producing supplemental disclosures that do not materially benefit shareholders.

City Trading Fund v. C. Howard Nye, et. al., 2018 WL 792283 (N.Y. Sup. Ct. February 8, 2018).

SPECIFIC LITIGATION EXCLUSION DOES NOT BAR COVERAGE FOR SUBSEQUENT LAWSUIT DESPITE OVERLAPPING FACTS

This coverage dispute arose following a series of lawsuits surrounding a failed go-private transaction and amendments to the insureds' Articles of Incorporation.

In 2010, the insured's CEO procured funding to take the company private; however, by the time an agreement was reached with shareholders who had originally objected to the transaction, financing fell through. Shareholders subsequently filed numerous lawsuits regarding the failed go-private transaction.

A lawsuit between the largest shareholder and the entity that withdrew its financing offer was also filed. Coverage for all of these suits was accepted by the insured's directors and officers liability (D&O) insurer.

To secure go forward D&O coverage, the insured's broker negotiated a specific litigation exclusion, intended to bar coverage for any subsequent suits arising out of the failed go-private transaction.

Shortly thereafter, the insured consummated a series of deals in furtherance of the goal of taking the company private. Additional shareholder lawsuits were then filed regarding these actions, which gave rise to this coverage dispute.

Relying on the specific litigation exclusion, the new D&O carrier denied coverage. The insureds successfully defended the lawsuits and then sought reimbursement from the carrier, alleging the denial to be improper.

Despite incredibly broad wording in the specific litigation exclusion, the court found in favor of the insureds, concluding the specific litigation exclusion was inapplicable.

The court based its decision on facts pleaded in the subsequent cases, while describing facts from the original proceedings as "window dressing" that provided some background information but were not operative facts that form the basis of the causes of action.

The court went so far as to admit that if the exclusionary clause were read literally, coverage would be barred, leaving readers with the impression it went out of its way to find coverage.

The takeaway from this case is to make sure exclusionary provisions are worded as narrowly as possible, and to seek the advice of an expert if there are ever any questions regarding what will and will not be covered under a particular policy.

Emmis Communications Corp. v. Illinois National Insurance Co., 2018 WL 1410191 (S.D. Ind. March 21, 2018).

D&O FILINGS, SETTLEMENTS AND OTHER DEVELOPMENTS

D&O FILINGS

As we previously reported, 2017 D&O filings were up 54% over 2016; at their second-highest level ever (highest = 2001)

In 1Q2018, filings continued at an elevated level, with 108 D&O Class Action Federal Securities Claims having been filed

- This implies an annualized number of 432 filings, which would be a 5% increase over 2017
- At this rate, **approximately 1 in 9 public companies are being sued for securities fraud**

Filings against NASDAQ companies remain more common than filings against NYSE companies in 1Q2018 (54% v. 41%)

D&O SETTLEMENTS

81 D&O Class Action settlements were approved in 2017, versus 85 in 2016

Aggregate value decreased substantially from $5.9 billion (2016) to $1.5 billion (2017)

- Four settlements exceeded $100 million (2016 = ten), and none exceeded $250 million (first time in over five years)

Average settlement size was $18.2 million in 2017

- 2017 settlements involved smaller cases compared to prior years, in part due to low stock market volatility in the years in which these cases were filed

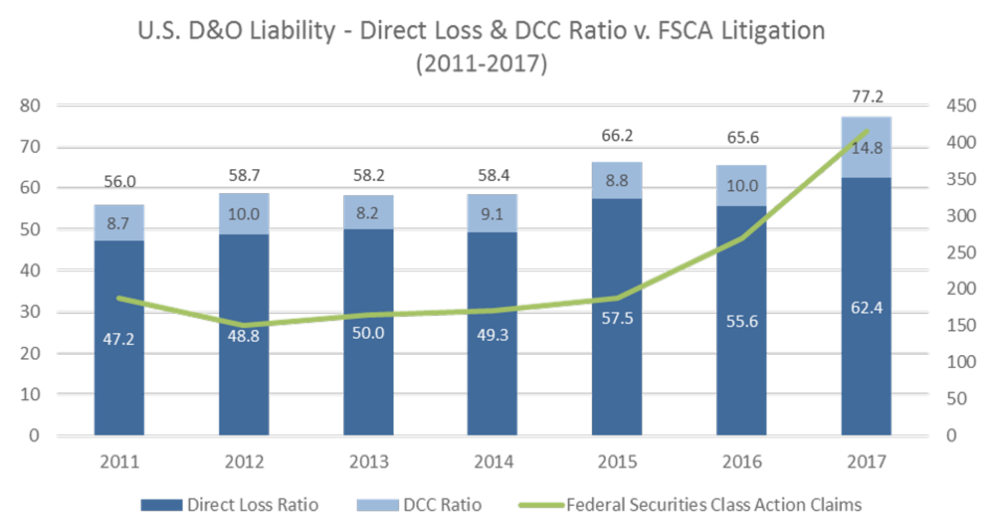
OTHER DEVELOPMENTS AND CONSIDERATIONS

Overall D&O pricing remains near a 15-year low, in part due to dismissal rates being at an all-time high (~50%)

- Excess layer pricing is noticeably more competitive than primary layer pricing, particularly in certain sectors

D&O insurer performance deteriorated noticeably in 2017, with many insurers making an underwriting loss

- Loss ratios increased by 18% in 2017, to their highest level in seven years
- Many leading D&O carriers have been pushing for slight primary layer rate increases in 1Q2018, but overall D&O pricing (when including excess layers) remains steady compared to 2017



Sources: Cornerstone Research; Stanford Law School; Center for Research in Security Prices; A.M. Best data and research

KEY CONTACTS

BRIAN R. BOVASSO
Managing Director
IMA Executive Risk Solutions
303.615.7449
brian.bovasso@imacorp.com

TRAVIS T. MURTHA
Director of ERS Claims
IMA Executive Risk Solutions
Legal & Claims Practice
303.615.7587
travis.murtha@imacorp.com

ABOUT IMA

IMA Financial Group is a privately held, diversified financial services firm focused on protecting client assets and creating exceptional value for our clients around the world. Our diverse team of experienced and talented professionals shares an unwavering commitment to excellence.

IMA Executive Risk Solutions is our world-class team of 20+ professionals focused on providing thoughtful advice, a unique legal perspective, a broad range of executive risk insurance solutions, and excellent service to our valued clients. Our professionals have deep experience handling complex executive risk exposures for a variety of clients – from pre-IPO start-ups to multi-billion dollar corporations.