IMA Executive Risk Solutions

Quarterly Update – Third Quarter 2020

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Cases of Interest

Publicly Traded Companies Targeted Over Lack of Diversity

The state of California recently passed legislation requiring publicly traded companies headquartered in the state to have at least one member of an "underrepresented community" on their Board of Directors by the end of 2021. This adds to prior legislation mandating female inclusion in Board membership that took effect in 2019.

As if on cue, seven separate lawsuits (six by the same firm) have now been filed against publicly traded companies that lack minority representation on their Board of Directors. Directors at Facebook, The Gap, Oracle, Qualcomm, NortonLifeLock, Danaher Corporation and Monster Beverage Corporation are now facing shareholder derivative complaints regarding the makeup of their Boards. All are California based companies, with the exception of Danaher.

Unlike the other six cases, the Danaher litigation was filed by the law firm of Robbins Geller Rudman & Dowd, whose entry into this sort of dispute is itself noteworthy. Practitioners familiar with the public equity markets are sure to recognize the name, as the firm has consistently been ranked as one of the top firms in both amounts recovered for shareholders and total number of class action settlements.

In each of these cases, the allegations focus on public pronouncements and expressions in support of diversity that are not actually being fulfilled. In the case of Monster, they include allegations of discrimination and harassment of women and minorities that dovetail with prior litigation over the perpetuation of a discriminatory culture.

The cases brought to date are all pleaded as shareholder derivative claims, but the relief sought varies from company to company. Generally, the appointment of at least one minority director to the Board is sought along with the creation of diversity and inclusion plans and establishing funds to promote diversity hiring and advancement.

Monetary damages are also sought in some cases, but by all indications, these cases appear to be filed in an effort to effectuate change within the companies.

Given that these cases have only just been filed over the last few months, it is difficult to predict where they will lead, including the extent to which they will impact companies based outside of California. What is clear, however, is that companies are facing ever-increasing scrutiny over hiring and management practices along with demands to diversify leadership roles without delay.

Cases of Interest

McDonald's and GM Sue Former Executives To Save Face

Litigation brought by a company against a former Chief Executive Officer or Director is a relatively rare occurrence. Nonetheless, two such suits have been filed this year. In the case of McDonald's, it has sued to recoup severance compensation paid to its former CEO. Following the termination 'without cause' last year, additional evidence allegedly revealed the CEO had lied during an internal investigation and was involved in three additional relationships with employees that were not disclosed.

The second case is being brought by General Motors against a former Board member over allegedly disloyal conduct that cost the company billions of dollars in labor costs and included an illegal kickback scheme. Following Joseph Aston's guilty plea in December 2019 for conspiracy to commit wire fraud and money laundering, GM is now pursuing him for damages and to recoup amounts paid to him during his tenure on the Board from 2014-2017.

The willingness of each company to air their dirty laundry in public, rather than the typical "disclose it and move on", is relatively unheard of. The likelihood of an award of damages or the recoupment of monies paid to both individuals also seem somewhat insignificant for massive multi-national corporations like GM and McDonald's. The motivation behind filing these cases appears to be public relations campaigns designed to reassure investors each Board takes these matters seriously and will take whatever actions are deemed warranted.

In the GM case, its former Director, appointed by the United Auto Works union as part of a collective bargaining agreement, is alleged to have actively worked against GM's interests and shared confidential information while merger negotiations were ongoing. The seriousness of foreign payments and self-dealing that affected labor negotiations and collective bargaining agreement terms where billions of dollars are at stake is beyond dispute, but it still seems more like a public airing of grievances than a case which will be prosecuted through trial or appeal. The ability to recoup billions from one individual personally simply isn't going to happen.

The conduct at issue in the McDonald's matter is certainly inappropriate and violated company policies, but it will not affect the financials of a company with a current market capitalization of approximately $170 billion. As such, these cases should be viewed not so much for the salaciousness of the allegations or money in dispute, but as attempts by both Boards of Directors to assert their authority and publicly vow to do better. And, perhaps most noteworthy, to possibly get out in front of shareholders bringing claims against them for allowing all of this to occur on their watch. Whether this approach will succeed remains to be seen.

Another interesting aspect of these claims is whether the individuals who have been sued will have their defense costs covered under their prior company's D&O insurance. Depending on how each company's D&O insurance program is structured, coverage may very well be afforded in the absence of a 'company versus insured' exclusion, an outcome that would most certainly be unexpected for either company.

Cases of Interest

Federal Forum Provisions Upheld by California State Court

On September 1, 2020, the San Mateo County Superior Court issued a lengthy (46 page) Order that could result in the stabilization of an exceedingly "hard" D&O insurance market for companies looking to go public. The dispute before the court involved the validity of a company's inclusion of a provision in its Certificate of Incorporation or other governing documents mandating that shareholder claims must be heard in federal court.

As readers likely recall, following the U.S. Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 583 U.S. ___ (2018), wherein the ability of shareholders to bring claims under the Securities Act of 1933 in either state court or federal court was upheld, the amount of IPO litigation filed in state courts increased dramatically.

Federal forum provisions have since been adopted as a creative work-around to this problem, but their validity remains shaky. In March of this year, the Delaware Supreme Court gave its nod of approval to such provisions, but did so in a circumscribed manner, noting it was only deciding the narrow issue of what could be contained in a Delaware corporation's Certificate of Incorporation.

A California state court upholding such provisions is therefore yet another positive development that will hopefully result in other state courts doing the same and lead to a closing of the significant gap between pricing of D&O insurance for mature public companies versus those that are newly public.

As with the decision of the Delaware Supreme Court in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), there is no guaranty a decision by a California Superior Court will result in other state courts uniformly falling in line, but it is a positive development in a marketplace where insureds are facing retention and premium levels that are multiples of what was seen a little over a year ago. We will continue to monitor this issue, as it surely is not the last word on this topic.

Wong v. Restoration Robotics, Inc., Case No. 18-CIV-02609 (Cal. Super. Ct., Sept. 1, 2020).

Cases of Interest

Excess Policy Triggered Despite Settlement by Insured with Underlying Insurer

As an update on a case discussed in our Third Quarter 2019 Quarterly Update, an excess insurer's arguments seeking to avoid payment in litigation have been roundly rejected.

In this case, D&O insurers had sought to avoid payment by triggering a 'specific litigation exclusion'. The court found this exclusion to be inapplicable, and the primary layer D&O insurer then settled the dispute with its insured for less than the full policy limit.

Following this, an excess layer insurer then attempted to deny coverage, arguing that the underlying payment of less than the full policy limit meant its excess layer policy was never triggered because the "attachment" point was never reached.

Relying on Delaware law and rejecting the excess layer insurer's reliance on cases from other jurisdictions, the court explained how Delaware treats settlements with insurers as an exhaustion of that policy absent an explicit provision to the contrary.

Referred to as the 'Stargatt Rule', Delaware courts have routinely held excess policies attach irrespective of whether the insured collected the full amount of the primary policy, so long as the excess insurer was only called upon to pay amounts in excess of the underlying limits.

"Excess coverage is triggered when the underlying policy limit is reached by the total costs incurred by the insured, regardless of whether the total payments to the insured by the underlying insurers reach those limits." The policy language in question here merely required the underlying policies be exhausted "by actual payment of claims". Further admonishing the excess insurer, the court noted Delaware law recognizes no business reason for an excess insurer to care whether the payment in satisfaction of an underlying policy was for the policy's full dollar value, only that the protections afforded by all underlying insurance were extinguished and the excess insurer's liability began at its negotiated attachment point.

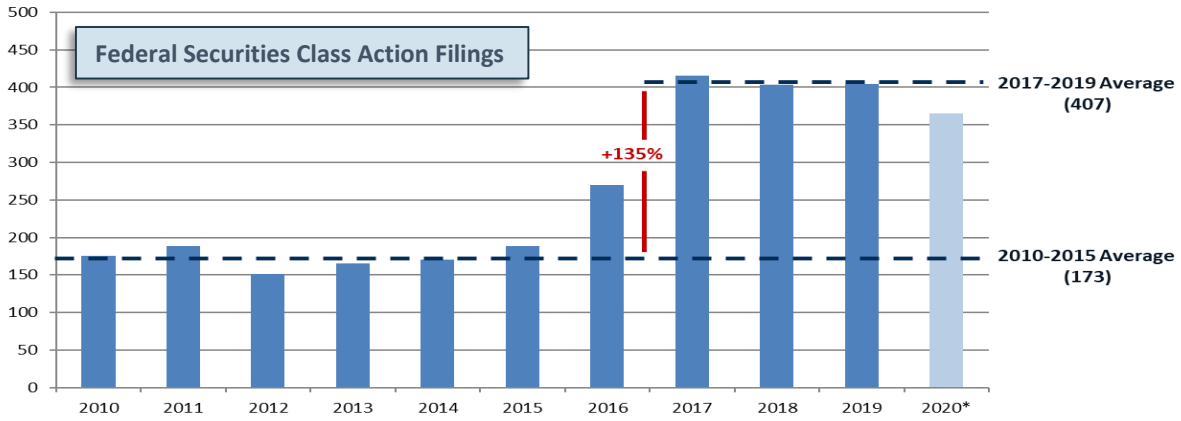
While the result here was in favor of the insured, it must be noted that California courts take a contrary approach, and the law is unclear in other jurisdictions. As such, the negotiation of payments from a carrier that act to exhaust a policy or resolve coverage disputes should only be undertaken with full knowledge of the policy language at issue and the state law governing policy language. Even better, insureds should be sure to secure proper "exhaustion" language within each excess layer policy, in order to minimize the likelihood of a similar coverage dispute.

Pfizer v. U.S. Specialty Insurance Co., 2020 WL5088075 (Del. Sup., August 28, 2020).

D&O Filings and Other Developments

D&O Filings

- As we previously reported, 2019 total Federal Securities Class Action Claims came in 134% *above* the 2010-2015 annual average.
- In 1H2020, filings were down slightly compared to 1H2019 (176 v. 197), but still well above historical norms.
- This slightly depressed filing pace *increased* noticeably in the third quarter of 2020, with 98 new claims having been filed.
- Filing rates through September 2020 imply an annualized number of 365 Federal Securities Class Action Claims.
    - An annual total of 365 filings would exceed the 2010-2015 annual average of 173 filings by 111%.
    - At this rate, **approximately 1 in 11 public companies are being sued for securities fraud.**



**Projected 2020 filing total based on number of suits filed through September*

Other Developments and Considerations

- With D&O litigation remaining elevated, carriers continue to push for noticeable rate increases on most layers.
    - Price increases continue to be most dramatic for companies with challenging risk profiles and in challenging sectors.
    - Companies considering an IPO can continue to expect elevated pricing and retentions ($5M-$10M+), as well as a decrease in carrier limit deployment.
- We have also seen upward pressure on retentions in 2020, although this began to stabilize in the third quarter.
- Fortunately, broad coverage remains available in the current marketplace, even for distressed companies.
- On the IPO front, 2020 is shaping up to be another strong year, with 144 companies raising a total of nearly $53 billion through September 2020.
    - This compares to 108 IPOs raising a total of $38 billion in the first nine months of 2019.
    - Blank check (aka, SPAC) IPOs have comprised a majority of the year-over-year difference, with 82 through 3Q2020.

Source: Cornerstone Research; Stanford Law School; IMA Proprietary database

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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.