EXECUTIVE RISK SOLUTIONS

APRIL 2024

Quarterly Update

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REGULATORY UPDATES

SEC Issues Revised Climate Rule which is Immediately Met with Multiple Challenges

In early March of this year, the Securities and Exchange Commission adopted a new rule requiring certain disclosures about climate-related risks that are likely to have a material impact on a company's business. This followed prior developments that indicated a strong likelihood the SEC would issue less stringent environmental impact rules than initially proposed, which we covered in our January 2024 Quarterly Update.

However, despite the scaled back nature of the new rule, it was met immediately by litigation and the issuance of an administrative stay by the Fifth Circuit Court of Appeals. The stay prohibited the SEC from enforcing the new rule until the court considered arguments against it brought by plaintiffs.

Soon thereafter, the Fifth Circuit dissolved its administrative stay after the Eighth Circuit Court of Appeals was selected in a lottery as the venue for a case that consists of nine consolidated lawsuits from across the country.

The rule at issue is intended to standardize climate-related disclosures from companies regarding greenhouse gas emissions and strategies for transitioning to a low-carbon economy. The goal, according to SEC Chair Gary Gensler, is to enhance the disclosures relied on by investors and provide reliable information on climate risks each issuer faces.

According to one of the lawsuits challenging the new rule, it would result in regulation of "significant aspects of the country's economy under the guise of requiring detailed (and wildly speculative) disclosures about 'climate-related risks' and 'greenhouse gas' emissions."

In the latest development, on April 4 the SEC submitted a court filing wherein it exercised its discretion to stay the final rule, thereby delaying implementation of the new climate-related disclosures pending judicial review of the Eighth Circuit petitions. Despite this recent development, the SEC has vowed to vigorously defend the rule in what is shaping up to be a protracted legal battle. We will continue to track developments in this matter and provide updates as appropriate.

SEC Extends its Reach with Successful Prosecution of 'Shadow Trading'

Earlier this month, a federal jury in California found a former employee of biotech company Medivation liable of insider trading following an eight-day trial. While an insider trading verdict is certainly nothing new, the premise by which this case was brought does mark a significant expansion of insider trading law.

Prior to this case, insider trading prosecutions have primarily focused on people who are alleged to have bought or sold a company's stock based on nonpublic information specific to that same company. Here, the defendant did not trade in the stock of his employer (Medivation) but rather in the stock of another drug company (Incyte) by purchasing call options in that company.

At the time of the alleged wrongdoing, Medivation had made the decision to be acquired by Pfizer but had not yet made this information public. Once the acquisition news broke, the share price of Incyte (and several other biotech companies) increased materially. The defendant then sold his options for a profit of just over $100,000.

According to the SEC, "this was insider trading, pure and simple". However, the defendant claims Medivation being for sale was public knowledge and that he was only "shadow trading" in the stock of a different company in the same industry. Furthermore, despite the fact that such a trade violated a Medivation company policy, the defendant argued that does not equate to violation of a federal statute.

It is important to point out that Congress has never clearly defined what constitutes insider trading. In denying a writ of certiorari in the insider trading case of *Whitman v. United States* back in 2014, Justice Antonin Scalia wrote that "only the legislature may define crimes and fix punishments. Congress cannot, through ambiguity, effectively leave that function to the courts – much less to the administrative bureaucracy."

The outcome in this recent case clearly expands the SEC's reach by allowing it to prosecute the trading in shares of a company about which the defendant had no insider information. It will be interesting to see what comes of this decision, including whether the SEC will look to more aggressively prosecute company employees for the trading of stock in other companies in the same industry group. *SEC v. Matthew Panuwat*, 2024 WL 1012916 (N.D. Cal. March 8, 2024).

+ *Bump-up Exclusion Bars Coverage for $90 million Settlement*

In another follow-up concerning a case we last covered in our April 2023 Quarterly Update, a federal district court sided with insurance companies in finding D&O coverage unavailable for settlement proceeds paid to conclude litigation relating to the merger of insurance brokers Willis and Towers Watson.

On remand from the Fourth Circuit Court of Appeals, the court was tasked with determining whether the $90 million paid to resolve the merger objection suits was excluded from coverage based on the presence of a "bump-up" exclusion within the D&O policies.

In accepting the insurers' arguments, the court found that the settlement constituted an increase in consideration paid to shareholders. Despite the statutory claims under Section 14(a) alleging inadequate disclosures in conjunction with the merger and the breach of fiduciary duty claims focusing on the conduct of individuals involved in merger negotiations, the settlement effectively increased the consideration paid to shareholders.

"The focus is therefore on the overall result – whether, at the end of the day, the former Towers Watson shareholders were paid additional monies because the amount they received in the merger was inadequate...In short, after giving all the words in the Exclusion their reasonable and ordinary meaning, the Court concludes that the Settlements 'represent' amounts that 'effectively increased' the consideration for the merger, such that the Exclusion unambiguously applies to the Settlement."

As previously mentioned in reporting on these legal proceedings, the fact that two of the largest insurance brokers in the world were unable to negotiate language that would afford insurance coverage for the settlement of these cases says a lot. Attention must be paid to every word in the policies, while at the same time being cognizant of the bigger picture. In this case, no amount of legal wrangling could change the fact that the settlement amounted to an increase in consideration and therefore triggered an exclusion within the D&O policies, rendering the entire $90 million dollar sum uninsured. *Towers Watson & Co. v. National Union Fire Insurance Co.,* 2024 WL 993871 (E.D. Va., March 6, 2024).

+ *Insurers and Courts Grapple with Question of When Distinct Cases are 'Related'*

Under claims-made insurance policies, insurers limit their exposure to multiple lawsuits arising out of the same set of facts by treating them all as one "Claim" for purposes of coverage. This prevents litigation filed over an extended period of time from impacting more than one policy period. The determination of whether separate lawsuits arise out of the same set of facts (i.e., whether or not they are "inter-related") is something that we are seeing litigated frequently. Five judicial opinions on this subject were issued within the last two months. As such, it's a topic that warrants attention.

In *Alexion Pharmaceuticals, Inc. v. Endurance Assurance Corp. et. al.*, a Delaware state court was required to assess whether a subpoena issued by the SEC during one policy period should be considered related to a federal securities class action filed in the subsequent policy period. The subpoena sought documents related to the insured's foreign and domestic grantmaking activities and compliance with the Foreign Corrupt Practices Act ("FCPA"). The securities class action alleged misleading statements regarding the company's financial success and sales practices. Chubb issued primary policies for both policy periods. It initially accepted the securities class action as a Claim first made in the second policy period but then reversed its coverage position, deeming the class action to have arisen from 'inter-related wrongful acts' reported in the first policy period (i.e., the SEC subpoena).

Unfortunately, the excess insurers on the two programs differed. This led to denials from a handful of excess insurers and, ultimately, this litigation. The insured took the position the subpoena and subsequent securities class action were not related, and the Delaware court agreed. The court relied on the "meaningful linkage" standard in assessing whether the two claims should be considered one for purposes of coverage. It specified linkage must be meaningful, not tangential, and it is not enough for two claims to simply mention some of the same facts. The end result was that coverage was found to exist under the subsequent insurance tower for the securities claim, despite Chubb having paid its limit under the prior policy period and having taken a legally incorrect coverage position.

In *Immunomedics, Inc. v. Hudson Insurance Co.*, the same Delaware judge was tasked with a similar dispute. After the first two insurers on a D&O tower paid their limits, the third excess insurer denied coverage, taking the position the litigation was related to an earlier case that began prior to the policy period. This insurer relied on the "prior notice" exclusion which explicitly referenced a prior securities claim filed in 2016. Utilizing the 'meaningful link' standard referenced above, the court evaluated the following to determine if the claims were related: (1) the parties, (2) the relevant time period, (3) the overall theory of liability, (4) a sampling of relevant evidence, and (5) the claimed damages.

Finding the parties, time periods, theories of liability, evidence and damages to all be different, the court rejected the third excess insurer's position that the claims were related and coverage was therefore upheld.

The New York case *Xerox Corp. v. Travelers Casualty & Surety Company*, involved one D&O program put into run-off and a second program under which the primary and first excess carriers each paid their policy limit. Travelers, as the second excess insurer, denied coverage under the second program, arguing the "prior acts" exclusion was dispositive. The court disagreed, finding the acts which gave rise to liability took place after the date the prior program was placed into run-off.

Under New York law, the court noted the standard for deciding the applicability of an exclusion using the 'arising out of' lead-in language required a showing that none of the causes of action could exist but for the excluded activity. In rejecting Travelers' contention that the lawsuits filed during the second program arose from the transaction which caused the first program to be put into run-off, the court found the causes of action did not target conduct pre-dating the runoff date. Accordingly, coverage under the second program was found to exist.

The fourth case entitled *Capwealth Advisors, LLC v. Twin City Fire Insurance Company* dealt with a situation where an insurer denied coverage under a "specific entity" exclusion. The insured's previously affiliated brokerage firm was wound down and closed in 2018. Twin City subsequently issued an investment-advisor liability policy excluding any claims 'by or against, or based upon, arising from, or in any way related to' the brokerage firm. In 2020, Wells Notices were issued and an SEC enforcement action was filed. Following the insurer's denial of coverage, this case challenged the denial. After the federal district court found in favor of the insurer, the Sixth Circuit affirmed the decision. Both courts rejected the insured's contention that the language was ambiguous and similarly rejected that coverage was illusory.

"At bottom, 'in any way related to' means 'related to,' which requires an unattenuated logical connection. The Claim was plainly related to [the brokerage firm]...Given the [brokerage firm's] centrality to the SEC's allegations, we conclude that the Claim 'related to' [the brokerage firm] and thus comfortably falls within the exclusion's scope."

Finally, *PNC Bank, N.A. v. AXIS Insurance Company* was a case decided by the federal district court in Pennsylvania regarding fraudulent activity which took place at a bank that was subsequently purchased by the insured. Following discovery of the predecessor bank's mismanagement of trusts, numerous lawsuits were filed against the successor bank.

The PNC insurance program at issue in this case incepted eleven hours before the acquisition was completed. Excess insurers on the program sought to disclaim coverage under the "Changes in Exposure" and "Interrelated Wrongful Acts" provisions.

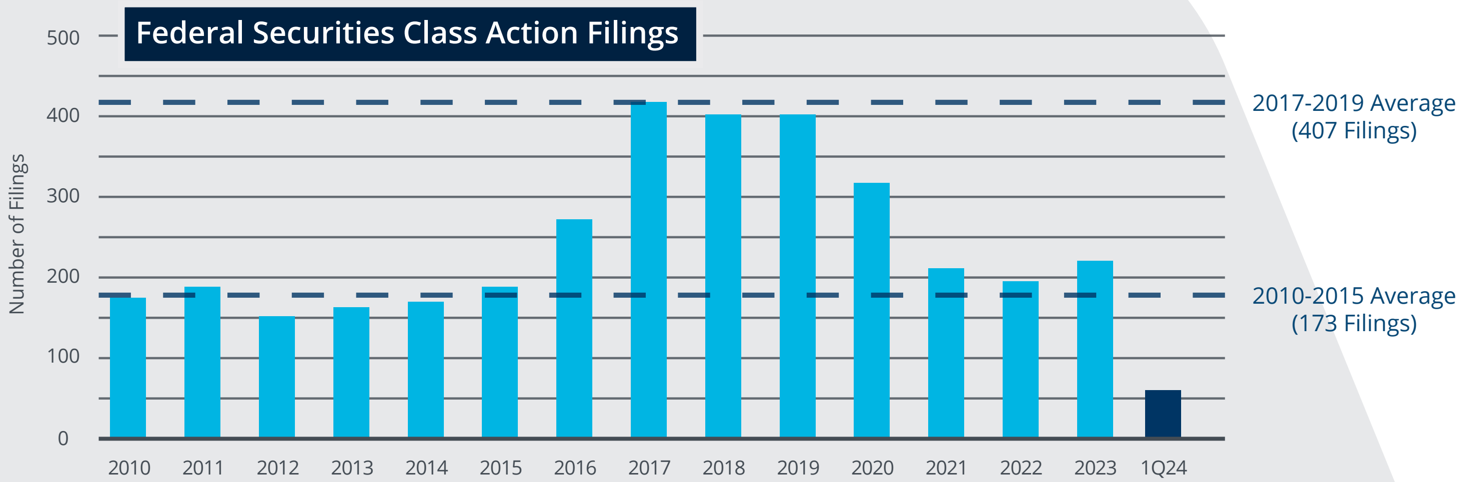
The Change in Exposure provision specified that coverage for acts of an acquired company only exists for wrongful acts committed, attempted, or allegedly committed or attempted, at the time of or after such event. "The language 'such event' in the provision refers to a merger, consolidation, or acquisition of another company. The plain language of this provision demonstrates that coverage does not exist for the 'Wrongful Acts' of an acquired company before an acquisition or merger." While finding this to exclude coverage, the court chose to rule on the Interrelated Wrongful Acts question as well. The policy defined this term to mean all causally connected wrongful acts.

"[B]ecause all three actions concern the same causally connected 'Wrongful Acts,' under the terms of the Interrelated Actions Provision, such 'Claims' are deemed to be made outside of the Policy Period." PNC was therefore left without coverage for the lawsuits relating to the acquired bank.

The foregoing cases demonstrate how different jurisdictions assess whether separate cases are related and the importance of the precise policy language itself. Discussions with your broker's placement and claims professionals during the renewal process to identify potential litigation risks cannot be stressed enough. With a full understanding of the insured's potential litigation risks, some of the coverage disputes discussed above may have been avoided. Nevertheless, insurers do not always get things right and having a team with expertise in drafting the best possible language, as well as dedicated claims professionals to back them up, is the best defense. *PNC Bank, N.A. v. AXIS Insurance Co.*, No. 21-01299 (W.D. Pa. Mar 13, 2024); *Capwealth Advisors, LLC v. Twin City Fire Insurance Company*, 2024 WL 1134647, (6th Cir., March 15, 2024); *Xerox Corp. v. Travelers Casualty & Surety Co.*, 2024 WL 1161218 (N.Y. App. Div., March 19, 2024); *Immunomedics, Inc. v. Hudson Insurance Co.*, 2024 WL 1235407 (Del. Sup., March 18, 2024); *Alexion Pharmaceuticals, Inc. v. Endurance Assurance Corp. et. al.*, 2024 WL 639388 (Del. Sup., February 15, 2024).

D&O FILINGS

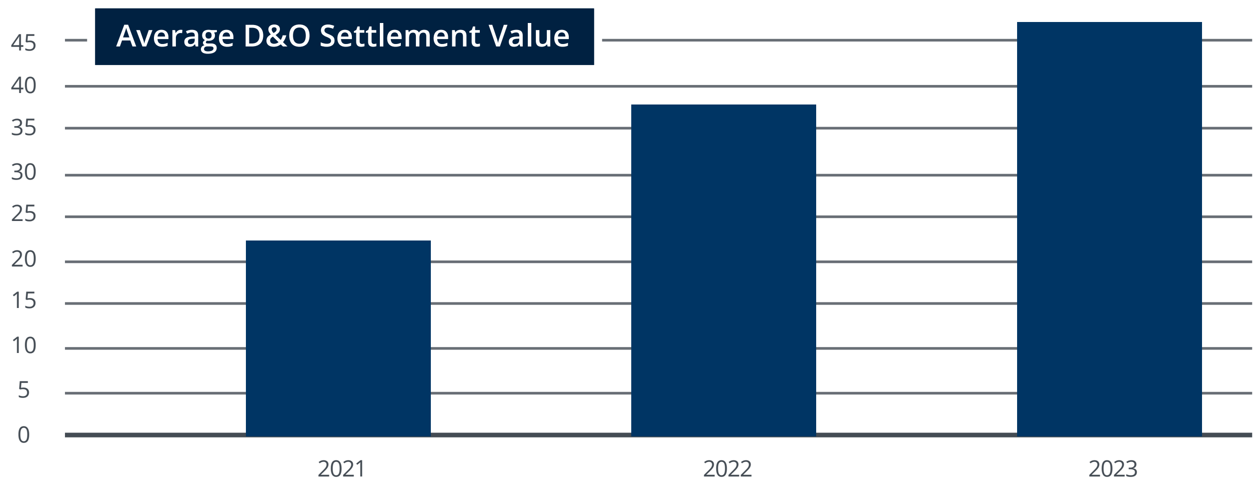
+ D&O Federal Securities Class Action Claims *increased* in 2023 for the first time in six years.
+ In 1Q 2024, filings remained in-line with 2023 levels, with 52 total FSCA Claims filed.



Note. Data from IMA proprietary database.

D&O SETTLEMENTS

+ 83 Federal Class Action Securities Claim settlements were approved in 2023, versus 105 in 2022.
  – A decrease in the number of settlements was expected, given the drop in filings beginning in 2020 and a median time of 3+ years from filing to settlement.
+ Average settlement size was $47.3 million, an increase of 25% over the 2022 average of $37.9 million.
+ 2023 also saw another increase in *median* settlement size, $15 million (versus $13.5 million in 2022).



Source: Data from Cornerstone Research, Securities and Class Action Settlements.

D&O PRICING

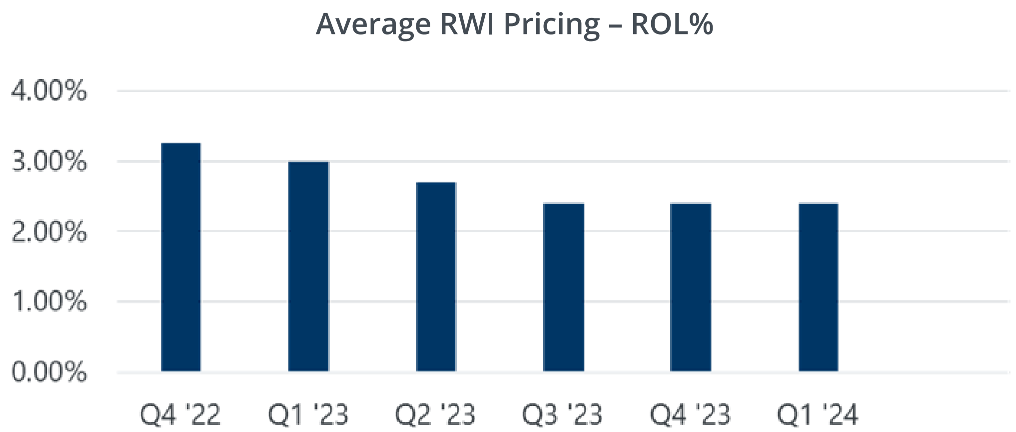
+ Despite the uptick in D&O filings in 2023, we continue to see pricing that is generally more favorable than year ago levels.
+ The current pricing environment continues to be a story of "supply and demand". New capacity has entered the market (supply) during a period where there are a significantly lower number of IPOs and de-SPAC transactions (demand). This combination of events has created more competition for "legacy" business. It remains to be seen whether the increase in litigation and any noticeable uptick in IPO activity will have a material impact on the current pricing environment.
+ As we look forward over the remainder of 2024, we are optimistic that the trends we have seen over the last several months will continue, although we will maintain a close watch on litigation trends and D&O carrier performance.

TRANSACTIONALLIABILITY

Reps & Warranties Pricing Update

+ After several consecutive quarters of declining pricing, we begin 2024 with a fair amount of rate stabilization. While certain underwriters are quoting premiums near 2% “rate on line” (i.e., pricing as a percentage of limit), in general pricing seems to have plateaued around 2.5%.

+ 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.



Reps & Warranties Claims Update

+ Claims data continue to indicate that 1 out of every 5 RWI policies placed (20%) 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.

+ Data remain consistent with roughly 80% of claims being noticed within the first 36 months of the policy inception date. However, we are monitoring a potential trend of more claims being noticed more than 12 months from closing, oftentimes representing traditional hold-back periods.

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More Than Just Insurance

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