May 2021

2021 Quarterly Review – First Quarter

News and Developments in Executive Liability and Insurance

In this Issue

From the Editors

Welcome to the First Quarter 2021 edition of the Quarterly Review. In this edition we address an important interpretation of the prior act exclusion by the Delaware Court, as well as the Delaware Court decision in *RSUI Indem. Co. v. Murdock*, when the court applied Delaware law to the coverage litigation and interpreted the conduct exclusion. We also address cases on notice, definition of securities claim, insurability and reasonableness of consent.

Cyber security remains a focus as we note the regulatory response to cyber incidents in our news section and case decisions on standing, privilege and ransomware.

Keep in mind that each case listed in our index of the securities class action cases filed in the First Quarter 2021 is hyper-linked to its corresponding summary page on the Stanford Law School Securities Class Action Clearinghouse database. If you click the name of the entity, that should bring you to the summary page.

As always, our team is available to discuss any of these issues with you. We hope you enjoy this edition of the Quarterly Review.

Jacqueline A. Waters, Esq.
Managing Director & Practice Leader

Robbyn S. Reichman, Esq.
Managing Director & Practice Leader

General News

Judicial Scrutiny Signaled by First Dismissal in Spate of COVID-19 Securities Class Actions

Since March 2020, over two dozen securities class action lawsuits with COVID-19 allegations have been filed. In January 2021, the United States District Court for the Central District of California issued a dismissal in one such action against a mortgage financing company and its directors and officers. The action mainly centered on allegations about the defendants' underwriting practices, such that the dismissal may not be indicative of how courts may treat COVID-19 related securities claims. However, there were allegations that the defendants failed to include risk factors related to the pandemic.

In dismissing, the court found that the defendant's allegedly misleading statements about its underwriting practices to be mere puffery. The court was also unpersuaded by allegations that the defendants failed to report on market uncertainties due to COVID-19. The IPO had closed in January 2020 and the plaintiff had not alleged that the defendants would or could have known the extent and impact of the pandemic at that time. Further, as to Item 105 of Reg. S-K, the court held that the plaintiff had not adequately alleged how the defendants could have known of the pandemic risk at the time of the IPO to include more specific warnings or disclosures.

The lawsuit is one of several which were filed, despite an IPO filing in January 2020, when the pandemic's impact was still developing. The case suggests that on a threshold level, courts will scrutinize allegations that defendants have purportedly failed to anticipate the pandemic and its consequences. *Berg v. Velocity Fin., Inc.*, 2021 U.S. Dist. LEXIS 17933 (C.D. Cal. 2021).

New York Department of Financial Services Imposes $1.5 Million Penalty for Cybersecurity Incident Response

The New York Department of Financial Services ("DFS") reached its first full resolution under its Part 500 Cybersecurity Regulation against a residential mortgage banker. The DFS set a $1.5 million penalty for violations such as the company's failure to investigate the contents of a phished and compromised email account and failure to conduct a cybersecurity risk assessment.

The security event at issue was a business email compromise, whereby the account of an employee handling personal loan application data was phished. The employee had authorized multiple requests on the company's multi-factor authentication system, even though she had not

recognized or made the attempts to access her account. After the DFS raised the issue, the company hired a law firm to determine its notification obligations. The company had also failed to conduct a risk assessment as required by Part 500.

The DFS assessed a $1.5 million penalty in consideration of factors such as the company's cooperation and good faith and the severity of the violation. In the resulting consent order, the DFS acknowledged the company's ongoing remediation efforts and required submission of a cybersecurity incident response plan and risk assessment/training initiatives.

The order suggests that the DFS will apply scrutiny to the adequacy of a cyber incident investigation (the company's failure to review the contents of the compromised account was "especially egregious") and the level of compliance with state breach notification laws. Further, it indicates that the DFS enforces the Part 500 requirement that a risk assessment be periodically conducted as part of a regulated company's submission of its annual certification of compliance. Additionally, the DFS appears to weigh the sufficiency of training per Part 500 requirements, as suggested by its request that the company provide its most recent training documents.

New York Legislators Introduce Biometric Privacy Bill

Privacy issues and related litigation are the among the top concerns of corporations. An area that is rapidly emerging is biometric privacy. A group of bipartisan legislators in New York introduced a bill that is similar to the Illinois Biometric Privacy Act (BIPA). Its introduction underscores the significance of privacy issues and key concerns.

The proposed law, A.B. 27, prohibits private entities from capturing, collecting, or storing a person's biometric identifiers or information without first implementing a policy and obtaining written consent. The legislation would prevent private entities in possession of biometric identifiers or biometric information from selling, leasing, trading or otherwise profiting from a person's biometric identifier or information. Like Illinois' BIPA, the bill would provide for a private right of

action with statutory damages of up to $1,000 for negligent violations and $5,000 for intentional or reckless violations, as well as reasonable attorney's fees. The bill is currently with the Consumer Affairs and Protection Committee for review.

The bill's development is expected to be closely watched. For reference, on Illinois' BIPA, approximately 1,000 class action BIPA lawsuits were filed from 2015 to 2020. Also, during that period, a large tech company settled a BIPA claim for $650 million.

Derivative Lawsuit on Board Diversity Dismissed

The United States District Court for the Northern District of California dismissed a derivative lawsuit against a social media giant, which alleged that its directors violated their fiduciary duties on diversity and inclusion issues. The court dismissed the suit based on its finding that the plaintiff had not "plausibly" pled demand futility or a materially false statement under Section 14(a) of the Securities Exchange Act of 1934. The court also dismissed based on a governing forum selection clause.

The lawsuit alleged that the company's diversity practices were "characterized by tokenism" and that the company had not achieved real diversity on its board or its senior executive ranks. Further, the lawsuit alleged that the company failed to rid the platform of discriminatory advertising and hate speech. The lawsuit contended that such failures amounted to a breach of fiduciary duties and rendered annual proxy statements about the company's diversity commitment to be false.

The court, in dismissing the action, found that the plaintiff had not "plausibly" plead demand futility, having offered no supporting particularity. The court also enforced the forum selection clause, dismissing the state claims on grounds that they should be brought in the Delaware Court of Chancery and severing/dismissing the plaintiff's Section 14(a) claim. In dismissing the latter claim without prejudice, the court determined that the statements at issue about diversity were "puffery or aspirational," and that allegations about widespread unlawful practices were inaccurate in light of the board's composition.

The dismissal may be unique, in that the company was able to dispute the plaintiff's specific allegations about the board's diversity. It is possible that the plaintiff, in potentially refiling the action, may emphasize the other allegations about the diversity of the workforce at large and the supposed failure of the platform to contain discriminatory and hate speech. In any event, the decision may have implications for other similar pending suits advancing diversity allegations, including the court's scrutiny on demand futility and statement misrepresentation. *Ocegueda v. Zuckerberg,* 2021 U.S. Dist. LEXIS 52465 (N.D. Cal. 2021).

Another Post-*Cyan* Decision Indicates a Trend to Urge Scrutiny of State Court Securities Cases

Another court has issued a decision following the 2018 landmark *Cyan* decision. In the March 2021 *Labourers' Pension Fund* case, a shareholder class action was filed in the Supreme Court of New York and alleged misrepresentations under the Securities Act of 1933 against the issuer and certain members of the board. The Appellate Division overturned the lower court ruling and found for the defendants. It found that the alleged misleading statements at issue were opinions and required plaintiffs to meet certain threshold requirements that the court said plaintiffs did not meet.

One may recall the *Cyan* decision stood for the premise that there can be concurrent jurisdiction in state and federal courts for Securities Act of 1933 claims. This increased the frequency of state court filings. Commentators questioned whether the state court judges would hold plaintiffs to the same pleading burdens that the federal court judges do. This *Labourers'* decision, second to the *Lyu* decision, suggests they will.

While many companies have adopted by-laws in response to the *Cyan* decision to ensure Securities Act of 1933 claims are asserted in federal court, it appears that state court judges are holding plaintiffs to the same or similarly strict pleading standards if cases are brought in state court. *Labourers' Pension Fund of Cent. & E. Can. v. CVS Health Corp.*, 2021 N.Y. App. Div. LEXIS 1386 (N.Y. App. 2021).

Cases of Interest

Coverage for Securities Class Action Lawsuit Not Precluded by Prior Acts Exclusion or Bump-Up Provision

The Delaware Superior Court recently held that the bump-up provision and prior acts exclusion in directors' and officers' liability policies did not preclude coverage for a class action lawsuit.

In this coverage dispute, the insured alleged that its insurers wrongfully denied coverage for defense fees and settlement of the class action. The underlying suit alleged violations of federal securities laws in connection with proxy solicitation statements pertaining to the insureds' recent merger and post-closing financial reports about the value of the resulting entity. This dispute involved two runoff towers of insurance for the two companies that merged and an additional tower for the resulting entity. One group of stockholders alleged violations of Section 10(b) when, after the merger, their directors and officers allegedly disseminated false information about the company's financial health and misled the shareholders about the value of their investment. The second set of shareholders alleged that, prior to the merger, their directors and officers allegedly made false and misleading statements in the proxy solicitation materials in violation Section 14(a).

In the coverage litigation, the go-forward insurer for the resulting entity argued that the prior acts exclusion barred coverage for the 10(b) claim because it is related to the 14(a) claim for wrongful acts that occurred prior to the policy period. The court disagreed and concluded that the 14(a) claim pertained to pre-merger conduct "to coerce stockholder approval of a transaction saddled with low-return prospects" and the 10(b) claim alleged wrongdoing in connection with post-merger financial reporting. "Accordingly, the 10(b) Claim isn't 'related' to the 14(a) Claim under Delaware law and Prior Acts Exclusion doesn't apply." The court held that "coverage for the 10(b) claim lies only with the [go-forward] Policies."

The court also determined that the bump-up provision in the first runoff tower did not exclude coverage for the 14(a) claim. In relevant part, the provision provided that "[i]n the event of a Claim alleging that the price or consideration paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest or assets in an entity is inadequate, Loss with respect to such Claim shall not include any amount of any judgment or settlement representing the amount by which such price is effectively increased..." The court found that the 14(a) claim was not exclusively about inadequate consideration. Additionally, the provision applied only to an acquisition defined as a "takeover of one corporation by another if both parties retain their legal existence after the transaction." Here, the 14(a) claim repeatedly referenced the term "merger" and the two merged companies did not retain a separate legal existence once the transaction was completed. The court thus held that the bump-up provision did not bar coverage for the 14(a) claim. *Northrop Grumman Innovation Sys. v. Zurich Am. Ins. Co.*, 2021 Del. Super. LEXIS 92 (Del. Super. 2021).

Related Claims

Related Claims Provision Found Unambiguous and Proper Basis for Late Notice Denial

The United States Court of Appeals for the Eighth Circuit enforced the notice requirement in an employment practices liability claims-made policy. In doing so, the court found unambiguous the policy provision deeming related claims to be first made at the time of the first claim. The provision supported denial and did not solely pertain to whether policy limits could be stacked. Further, the insurer was not estopped from denying coverage despite denying more than a year after notice.

A teacher at the insured school district filed an EEOC charge alleging discrimination during the first policy period and filed suit in the following renewal period. Under the policy language for both periods, the EEOC charge was a claim and claims arising out of the same alleged wrongful and interrelated wrongful acts were deemed a single claim made when the first such claim had been made. The policy, as to claims first made in the first policy period, required notice no later than 60 days after expiration of that first period. The insured gave notice in the second policy period, six months after the expiration of the first period and ten months after receipt of the charge. After the insurer denied based on late reporting under the first period and the claim pre-dating the second period, the insured sued for coverage.

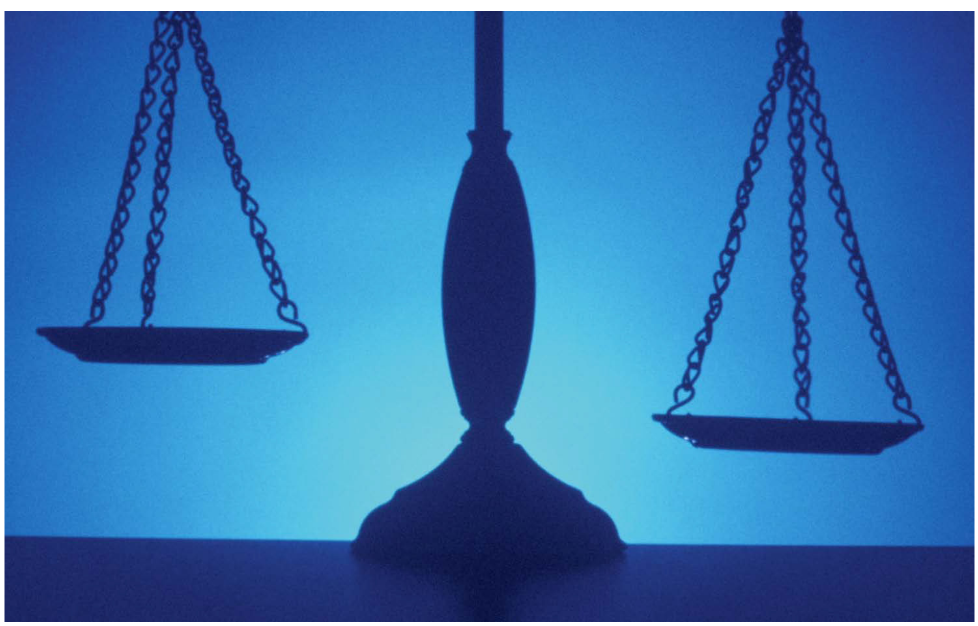
The lower court granted summary judgment to the insurer, which the court affirmed. The insured had argued that the provision relating claims should not preclude coverage, since it was contained in the section on limits of liability and could therefore be construed to govern only the stacking of limits. In rejecting this argument, the court observed that the insuring agreement too reinforced coverage only for claims first made during the policy period, such that it "dovetail[ed]" with the related claims provision. The provision "unambiguously does bear upon the scope of coverage, *i.e.* what substantive claims are covered, not just upon calculating the limits of [the insurer's] liability or retention amounts."

Additionally, the court was unpersuaded by the insured's waiver and estoppel arguments. The insurer did not deny until approximately fourteen months after notice but within two months of receiving the charge that it had repeatedly requested. The court reinforced that waiver and estoppel could not "be given the effect of enlarging or extending the coverage as defined in the contract." *Pine Bluff Sch. Dist. v. Ace Am. Ins. Co.*, 2020 U.S. App. LEXIS 40402 (8th Cir. 2020).

Coverage Precluded for Lawsuit Alleging Same Circumstances Asserted in Email Received Before Policy Period

The United States District Court for the Central District of California held that a claims made policy did not provide coverage for a lawsuit that included allegations previously made in an email to the insured prior to the inception date of its management liability policy. The insured received an email from its independent contractor, alleging harassment and seeking renegotiation of her contract with the insured. After her contract was terminated, the contractor filed a charge of discrimination and then a lawsuit, alleging causes of action such as sexual harassment and retaliation. The insured submitted the claim under two consecutive policy periods.

Coverage was denied under the first period due to the insured's failure to provide notice within one hundred eighty days of the expiration of the policy. Coverage was denied under the second period because the lawsuit was not a claim first made under the policy. The policy provided that the "[Insurer] shall pay, on behalf of an Insured Person, Loss on account of a Claim first made against the Insured Person during the Policy Period" and



"on behalf of an Organization, Loss on account of a Claim first made against an Insured Person during the Policy Period." The policy defined claim as "[a] written demand ... for: (1) monetary or non-monetary (including injunctive) relief; ... against an Insured for a Wrongful Act, commenced by the first receipt of such demand by an Insured."

The parties agreed that there was no coverage under the earlier policy because notice was not provided within one hundred eighty days of the expiration. The court then analyzed coverage under the subsequent policy. The insured argued that the email was not a claim, and therefore, not a claim related to the subsequent lawsuit. The court concluded that the email was a written demand that "demanded monetary relief in the amount of a settlement of seven figures." The court continued that the "email and the lawsuit are Related Claims because they arose from 'related facts, circumstances or Wrongful Acts.'" The email outlined the assault and retaliation which was "clearly related to the claims for assault, battery, and retaliation in the lawsuit." The court thus found for the insurer on both policy periods. *Peachstate Health Mgmt. LLC v. Chubb Ins. Co.*, 2020 U.S. Dist. LEXIS 224370 (C.D. Cal. 2020).

Notice

In Kentucky, Notice Prejudice Rule Does Not Apply to Claims Made Policies

The Kentucky Appellate Court overturned a lower court ruling for an insured which held that a professional liability policy was subject to the notice prejudice rule and the insurer should provide coverage for a claim noticed after the end of the reporting period.

The insured received a claim on June 23, 2015. The applicable policy period ran from July 1, 2014 to July 1, 2015. The insured submitted the claim to its professional liability policy insurer on October 2, 2015, 93 days after the end of the policy period. The insurer denied the claim and the insured sued three years later. The lower court determined that although the matter was noticed late according to the policy, the 90-day extended reporting provision in the policy was ambiguous. The lower court thus held that by applying the notice prejudice and the mail-box rules, the claim was received within the policy period.

On appeal, the appellate court reversed finding the policy provided a clearly defined reporting timeframe and process. Therefore, the policy was not ambiguous. The court then evaluated public policy and notice prejudice cases in related jurisdictions, as there had been no cases on the issue in Kentucky. The court said that to apply the notice prejudice rule to claims made and reported policies would give the insured more coverage than the policy was designed to provide. The policy was intended to provide "coverage during the life of the policy." Therefore, courts strictly construe the reporting requirements in such policies. To do otherwise, ruled the court, would be to grant the insured coverage for which they did not pay. *Darwin Nat'l Assur. Co. v. Ky. State Univ.*, 2021 Ky. App. LEXIS 31 (Ky. App. 2021).

Securities Claim

Fraudulent Transfer in Bankruptcy Considered a "Securities Claim"

In this insurance coverage case, the court was faced with the question of whether a bankruptcy trustee's fraudulent transfer claim against the company was considered a "Securities Claim" under the relevant D&O policies.

The facts of the underlying matter involved a complex transaction whereby Verizon spun-off a telecommunications portfolio to FairPoint Communications, Inc. Following the transaction, FairPoint Communications filed for bankruptcy in 2009, emerging in 2011. The bankruptcy trustee sued Verizon in 2011 in connection with the deal, in a "fraudulent transfer" lawsuit. The Trustee alleged that FairPoint was already insolvent at the time of the transaction and thus sought to set aside or avoid the actual and alleged fraudulent transfers connected to the transaction.

Verizon noticed and presented the claim to its insurers and the insurers denied coverage under several grounds including, in part, that the claim did not satisfy the definition of a "Securities Claim." The court, in reviewing the matter, analyzed whether the action was "brought derivatively on the behalf of an organization by a security holder of such organization", as required by the policy language. Through its' analysis of the phrases, and the law, the court found:

- The notes issued in connection with the transaction were "securities";
- The trustee was a "security holder" of FairPoint;
- The action was brought "derivatively"; and
- The action was "brought on behalf of" the company;

For those reasons, the court concluded that the definition of "Securities Claim" was satisfied, determined that the company policyholder was entitled to coverage, and found that the company could recover defense costs. *Verizon Communs., Inc. v. Nat'l Union Fire Ins. Co.*, 2021 Del. Super. LEXIS 157 (Del. Sup. 2021).

Breach of Fiduciary Duty Claim Is Not a "Securities Claim" Under D&O Policy

A court granted summary judgment to an insurer ruling that a shareholder lawsuit against an insured entity and its directors and officers, alleging breach of fiduciary duties in a merger transaction, did not constitute a "Securities Claim" under the applicable D&O policy.

In support of the motion for summary judgment, the insurer asserted coverage was unavailable because the lawsuit was not a "Securities Claim" under the policy. The policy defined "Securities Claim" in as

> a Claim ... made against any Insured for: (1) any actual or alleged violation of any federal, state, local regulation, statute or rule (whether statutory or common law) regulating securities, including but not limited to the purchase or sale of, or offer to purchase or sell, securities which is: (a) brought by any person or entity based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving the purchase or sale of, or offer to purchase or sell, securities of the Company ...

Neither party asserted that the Securities Claim definition in the policy was ambiguous and the court applied the plain meaning of the definition and stated that a "Securities Claim" has three parts: (1) an actual or alleged violation (2) of a regulation, statute or rule, that (3) regulates securities. The insured contended that the lawsuits satisfied the first two parts of the Securities Claim definition because the term "rule" includes common law, and claims for breach of fiduciary duties are based on violations of common law. However, the court determined that the lawsuits did not satisfy the third part of the definition because fiduciary duty claims do not regulate securities. In support of its position, the court cited *In re Verizon Insurance Coverage Appeals* where the applicable D&O policy had a nearly identical definition of "Securities Claim." The *Verizon* court held that rules "that regulate securities are those specifically directed toward securities, such as the sale, or offer for sale, of securities" and breach of fiduciary duty claims are not "specifically directed toward securities" and "do not depend on a security being involved, and indeed encompasses a wide variety of claims involving persons in special positions of trust and reading the phrase "regulating securities" to cover fiduciary duty claims would be "inconsistent with the plain meaning of the term."

Finding that there was no "Securities Claim", the court entered summary judgement in favor of the insurer and against the insured. *Calamos Asset Mgmt. v. Travelers Cas. & Sur. Co. of Am.*, 2021 U.S. Dist. LEXIS 31103 (D. Del. 2021).

Antitrust Exclusion

Antitrust Exclusion Does Not Bar Coverage for Consumer Protection Claims

The United States District Court for the Central District of California was called upon to decide whether an antitrust exclusion contained in a directors and officers (D&O) policy barred coverage for claims that the sports equipment manufacturer misrepresented the weights of its baseball bats on their labeling. The consumers brought these claims in a class action complaint, seeking relief under various California consumer protection and unfair competition statutes.

The manufacturer noticed the suit to its D&O insurer, which denied coverage based on an exclusion for claims alleging "any violation of any law" with respect to "anti-trust, business competition, unfair trade practices or tortious interference." The court found that the exclusion did not bar coverage and interpreted the phrase "unfair trade practices" to refer to anti-competitive business conduct, but not consumer protection claims. The court determined, utilizing contract interpretation principles, that the antitrust exclusion did not expressly include consumer protection claims or cite consumer protection laws, opining that "[i]t would be strange for [the insurer] to intend to include a consumer-protection component in an exclusion titled 'Anti-Trust Exclusion' without mentioning words such as 'fraud,' 'misrepresentation' or 'consumer protection.'" In addition, the excluded conduct referred only to "anti-competitive business practices," but not to "any conduct directed at consumers." The court also noted that the policy did not specifically eliminate coverage for false advertising or misrepresentation in advertising or labeling, which the court recognized the carrier excluded in other policies. Accordingly, the court ruled that the exclusion did not apply, and found in favor of the insured. *James River Ins. Co. v. Rawlings Sporting Goods Co.*, 2021 U.S. Dist. LEXIS 20970 (C.D. Cal. 2021).

Conduct Exclusion

Fraud Exclusion Does Not Apply to Underlying Finding of Breach of Loyalty

The Delaware Supreme Court issued a ruling in an important coverage case applying Delaware law in a litigation brought by excess directors and officers liability insurers.

The matter stems from a claim involving a go-private transaction in which the insured's chief executive officer was to acquire approximately 60 percent of the shares of the company that he did not already own. The stockholders sued in Delaware State Court alleging breaches of fiduciary duties by certain executives in that they had manipulated and artificially deflated the stock price prior to the completion of the merger. This case was ultimately tried, and the court found that they had breached their duty of loyalty to the shareholders through unfair and fraudulent actions. They were ultimately ordered to pay the adjudicated difference in the price per share. An additional class action brought by different investors with similar allegations was also settled.

Several excess insurers filed a declaratory judgment action seeking a determination negating coverage for the settlement. The insureds counterclaimed for breach of contract and bad faith. All insurers settled with the insureds prior to this decision apart from the eighth level excess carrier. The court took on a full review of the choice of law applying a "most significant relationship test."

After finding that Delaware law applied over California law, the court turned to coverage for an alleged breach of loyalty based upon fraud. The court observed that corporations were enabled to obtain D&O coverage "against any liability" and ultimately concluded that there was no public policy specifically prohibiting the insurability of loss resulting from an alleged fraud. The court then turned to the exclusion within the policy which provided that "[t]he Insurer shall not be liable for **Loss** on account of any **Claim:...**based upon, arising out of or attributable to... any...fraudulent act...by the **Insured**...if established by a final and non-appealable adjudication adverse to such **Insured** in the underlying action." Here the court concluded that the exclusionary language did not bar coverage for the underlying settlement focusing on the portion of the exclusion noting that the finding had to be "in the underlying action" and differentiated the two actions. The court noted that the adjudication of fraud in the first stockholder action was not relevant to the inquiry of its applicability to another action in which there was no such adjudication of fraud (as the matter had been settled).

This analysis by the Delaware Supreme Court is impactful as Delaware has an overall reputation for being policyholder friendly and the state of incorporation of many corporations. The analysis on the insurability of findings of fraud is also of significant importance in this area of jurisprudence. *RSUI Indem. Co. v. Murdock*, 2021 Del. LEXIS 90 (Del. 2021).

Negligent Misrepresentation Does Not Trigger Conduct Exclusion

The United States District Court for the Northern District of California ruled that a conduct exclusion in a directors and officers policy was inapplicable because there was no finding of dishonest conduct or a final judgment as required by the exclusion.

The president of the insured company convinced several individuals to invest in the company. An investor subsequently commenced a lawsuit against the president alleging negligent misrepresentation and breach of fiduciary duties for his alleged fraudulent inducement of investments. The lawsuit was submitted to arbitration and two more investors joined as claimants. The D&O insurer provided the president with a defense under a reservation of rights. The arbitrator determined that the two newly joined investors prevailed on their causes of action for breach of fiduciary duty and negligent misrepresentation, but not on their causes of action for fraud and awarded damages accordingly. After entry of the arbitration award, the parties entered into a confidential settlement agreement that settled the claim. Thereafter, the insurer filed a lawsuit against the president to recover the settlement amount and defense costs, asserting that the policy's conduct exclusion barred coverage for those amounts.

On a motion to dismiss, the court rejected the insurer's contention concerning the applicability of the exclusion, which provided in pertinent part that the insurer shall not be liable for "loss" on account of any Claim "in any way involving ... any dishonest, deliberately fraudulent or criminal act of an Insured," provided that "the exclusion does not apply until there is a final judgment against such Insured as to such conduct (emphasis supplied)." The court observed that the exclusion clearly required a "final judgment" and not merely a "final adjudication of disputed facts."

Applying its policy reading to the facts, the court determined that "there was no final judgment in the underlying action because the case settled and the arbitration award was never subsequently confirmed by a court." Just like there was no final judgment, the court determined that there was no finding of "intentional, fraudulent, or criminal conduct" by the president in the underlying arbitration. The court rejected the insurer's argument that the arbitrator's finding of misrepresentations by the president constituted a finding of "dishonest" conduct that triggered the exclusion. The court observed that under California law, negligent misrepresentation is not based upon dishonesty and that there was "no dishonest act found by the arbitrator upon which the conduct exclusion can be based." Indeed, the arbitrator found that the president's statements were based on an honest belief in the company's potential for growth and prosperity, although he had no reasonable basis for such belief. The court thus ruled that the exclusion was not triggered and granted the insured's motion to dismiss. *Scottsdale Ins. Co. v. Fineman*, 2021 U.S. Dist. LEXIS 22556 (N.D. Cal. 2021).

Insured v. Insured Exclusion

Insured v. Insured Exclusion Precludes Coverage for Entire Suit Brought by Both Insureds and Non-Insureds

The United States District Court for the Eastern District of Kentucky ruled that an insured vs. insured exclusion in a directors and officers policy that included an assistance exception precluded coverage for an *entire* lawsuit brought by both insureds and non-insureds. Further, the insurer was not required to allocate and cover some component of the lawsuit.

Several shareholders of a family-owned company brought suit against the president of the company. One of the plaintiffs was a director of the company, but other plaintiffs did not hold positions as directors or officers. The insurer denied the company president's request for coverage based on the insured vs. insured exclusion, which precluded coverage for any claim made against any insured by or on behalf of any insured or any security holder of the company. The exclusion contained an "assistance exception" for claims brought by security holders "acting totally independently of, and without the solicitation, assistance, active participation or intervention of the company or any insured person."

In the ensuing coverage litigation, the court granted the insurer's motion to dismiss, holding that the insurer owed no duty to defend or indemnify the company's president in connection with the underlying action. The court rejected the insured's contention that an allocation was necessary because some of the plaintiffs were insureds or security holders while another plaintiff was not an insured. Specifically, the court determined that the insured vs. insured exclusion's assistance exception did not apply in this instance because an "Insured Person" as defined by the policy had in fact actively participated in bringing the lawsuit.

The court concluded that because a claim was defined by the policy to include an *entire* civil proceeding, the policy language contemplated that the exclusion would operate to preclude coverage for an entire lawsuit. The court also distinguished other cases which required allocation, pointing out that the policies in those cases lacked the assistance exception at issue here. *Tarter v. Navigators Ins. Co.*, 2021 U.S. Dist. LEXIS 8341 (E.D. Ky. 2021).

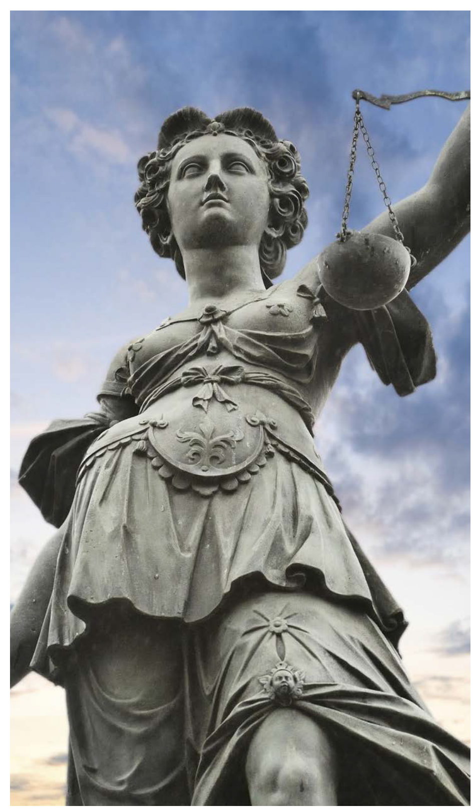
Consent

Reasonableness of Withholding Consent Should be Viewed from Insurer's Perspective

The Arizona Supreme Court decided that the reasonableness of an insurer's decision to withhold consent should be assessed from the perspective of the insurer, after certifying the following clarified question: "Should the federal district court assess the objective reasonableness of [the insurer's] decision to withhold consent from the perspective of an insurer or an insured?"

The insured's shareholders sued it for securities law violations after a significant stock drop. The suit was dismissed with prejudice for failure to particularly allege falsity. During the pendency of the appeal, the insured settled the claim, paying out of pocket because its Directors & Officers Liability insurer refused to consent to the settlement. The insured then sued its insurer for breach of contract and bad faith.

The district court granted summary judgment to the insurer and the insured appealed to the Ninth Circuit, which certified the question to the Arizona Supreme Court. At the outset, the court acknowledged that when an insured and insurer both have an interest in the defense but only one has control, there are bound to be conflicts around settlement. The court reflected on whose perspective – the insured's or the insurer's – should be considered when determining whether the settlement was reasonable. The policy terms stated that " [t]he Insureds shall not ... enter into any settlement agreement ... without the prior written consent of the Insurer" and that " [o]nly those settlements ... which have been consented to by the Insurer shall be recoverable as Loss under the terms of this policy." Lastly, "[t]he Insurer's consent shall



not be unreasonably withheld." The policy had no cooperation clause and the insured (not the insurer) had the duty to defend.

In reviewing those terms, the court noticed that the policy only referred to the insured in terms of what it could not do – enter into a settlement without consent. The balance of the consent clause speaks to the insurer's perspective, referring thrice to the insurer's consent. The court remarked that "the action referred to is the insurer withholding consent to settlement; the requirement that withholding consent may not be unreasonable is directed to the insurer as well." The court found support in the nature of the contract. In particular, the fact that the defense was controlled by the insured, with settlement subject to consent was persuasive. Where the insurer had no control over the litigation, it made more sense that reasonableness would be considered from the insurer's perspective so that unnecessary payment could be avoided.

In the court's view, "where there is no duty to defend, and the contract requires an insurer to not unreasonably withhold consent to a settlement proposed by the insured and a third party, we will examine whether the insurer's decision to withhold consent to a settlement is reasonable from the insurer's perspective." The court looked to law regarding the tort of bad faith to help determine whether an insurer reasonably withholds consent. It described the insurer's role as "an almost adjudicatory responsibility", which requires the insurer to "evaluate the claim, determine whether it falls within the coverage provided, assess its monetary value, [and] decide on its validity." The insurer may "discount considerations that matter only or mainly to the insured", such as financial status, public image, and policy limits, and may choose not to consent if the settlement amount "exceeds the insurer's reasonable determination of the value of the claim." *Apollo Educ. Grp., Inc. v. Nat'l Union Fire Ins. Co.,* 2021 Ariz. LEXIS 8 (Ariz. 2021).

Insurability

Disgorgement, Restitution and Insurability under Delaware Law

In a victory for a policyholder private equity firm, a Delaware judge ruled that disgorgement and restitution may be insurable under Delaware law as a matter of public policy. The court emphasized that any public policy against insurability of restitution and disgorgement should be left to the legislature.

In this action, the insured sought to recover its losses incurred in an underlying bankruptcy proceeding. The bankruptcy estate sued the private equity firm alleging fraudulent conveyance, breach of fiduciary duty and related business torts. The suit concerned the firm's raiding of an acquired company's high-performing assets. The parties settled and the firm sought coverage for indemnity and defense costs under its directors' and officers' ("D&O") and errors and omissions ("E&O") liability policies.

The policies' definition of Loss excludes "amounts which are uninsurable under the law most favorable to ... insurability." The policies were brokered and issued in New York where the insured was headquartered; however, the insured was incorporated in Delaware. The insurers denied coverage for multiple reasons, including on the basis the loss was uninsurable as a matter of public policy ("Uninsurability Defense") as it represented disgorgement or restitution of ill-gotten gains from the pre-bankruptcy asset sales. The insurers argued the "law most favorable" language in the policy was not a choice-of-law provision. The insured, on the other hand, asserted there was no public policy in Delaware which prohibited coverage for restitution or disgorgement and the "law most favorable" language was a choice-of-law provision which allowed the insured to select the jurisdiction provided it was reasonable.

The court, in turn, found that the "law most favorable" language was "unambiguously a choice of law provision" and that Delaware law controls. Further, "any Delaware public policy against *insuring* conduct for which restitution and disgorgement is appropriate must be expressed by the legislature, not the judiciary." The Delaware "legislature has left the issue as one to be negotiated by contracting parties." The court rejected the insurers' argument that the "the law most favorable provision is not a choice of law clause because it fails to specify which state's law was applicable." Finally, the court reasoned that Delaware had a "superseding interest in the merits of disputes involving insurance coverage for fiduciary mismanagement of Delaware organizations." *Sycamore P'rs Mgmt., L.P. v. Endurance Am. Ins. Co.,* 2021 Del. Super. LEXIS 182 (Del. Super. Ct. 2021).

Duty of Care

Caremark Liability Not Established in Derivative Case

The Delaware Chancery Court was provided with another opportunity to review potential *Caremark* liability in a derivative case involving a company's board's alleged failure to abide by the terms of a 2012 deferred prosecution agreement.

In 2012, federal prosecutors alleged that the company failed to comply with anti-money-laundering requirements. The company avoided prosecution by entering into a deferred prosecution agreement (the DPA). The plaintiff alleged that, notwithstanding the DPA, complaints of fraudulent and illegal activities did not decrease, and the company was unable to meet the requirements of the DPA. The company thereafter was compelled to pay an additional $125 million into the victims' restitution fund and extend the DPA for an additional four years.

The plaintiff brought claims against the company's directors and two of its officers, alleging that these individuals had failed "to exercise oversight sufficient to comply with their fiduciary duties." Specifically, plaintiff asserted that the defendants had failed the second prong articulated by the Supreme Court of Delaware in its landmark *Caremark* decision – namely that the defendants had in fact established compliance systems but, "having implemented such a system or controls, consciously failed to monitor or oversee operations thus disabling themselves from being informed of risks or problems requiring their attention."

Prior to filing the action, the plaintiff did not make a pre-suit demand on the board to take action because, as the plaintiff alleged, such a demand would be futile since the director-defendants, as parties to the case, were interested in the outcome. The Court of Chancery reaffirmed that a demand is not excused simply because directors are named as defendants in a lawsuit. Rather, a plaintiff must plead facts implying a substantial likelihood of directorial liability to satisfy the derivative action pleading requirements.

In addition, the court observed that the company's certificate of incorporation included an exculpation clause that exculpated directors from liability for breaches of the duty of care. Therefore, to survive a motion to dismiss, plaintiff was required to plead with particularity that defendants had knowingly acted in bad faith. The court analyzed the "red flags" in the company's compliance attempts in support of "bad faith" claim, but ultimately concluded: "The DPA left it up to the company to devise methods to prevent agent fraud; on the Defendant Directors' watch the company implemented such actions, but with insufficient speed and skill. But this allegation simply tells me the Board did a poor job applying its discretion to act; to my mind, this does not reasonably imply bad faith."

Going further, the court held that the facts of this case only "suggest a failed effort, not one opposed to the interests of the company or otherwise in bad faith." Although the court did say that it "is conceivable that a purported attempt at remediation could constitute bad faith; for instance, a mere sham remediation or an insincere action to fool regulators may be actionable." However, "[i]f a failed directorial attempt to remediate a problem is, because of its failure, actionable, a perverse incentive will be created." *Richardson v. Clark*, 2020 Del. Ch. LEXIS 378 (Del. Ch. 2020).

Cyber

Coverage Denial for Ransomware Attack Under a Crime Policy Remanded

The Indiana Supreme Court addressed whether there was coverage under a commercial crime policy for a loss resulting from a ransomware attack, remanding the insurer's denial partly based on its view that the loss was direct and that the insured's ransom payment was not voluntary per the crime policy's computer fraud insuring agreement.

After the insured discovered that it was locked out of its computer systems by an unknown person or entity, it initiated contact first with the FBI, and then with the hackers to negotiate the release of its servers. The insured ultimately paid a ransom in bitcoin. Soon after the ransom payment, the insured sought coverage under the computer fraud provision of its crime policy, which covered loss "resulting directly from the use of any computer to fraudulently cause a transfer of money." The insurer denied coverage for the reasons that the attack did not "fraudulently cause a transfer of money," and the loss did not result "directly from the use of a computer."

Following the lower courts' ruling in the insurer's favor, the Indiana Supreme Court reversed and remanded. With respect to whether the loss "resulted directly from the use of a computer," the insured argued that the loss satisfied this requirement because a computer was part and parcel of the entire scheme. The insurer countered that the insured's voluntary payment of bitcoin "was an intervening cause that severed the causal chain of events."

After analyzing the definition of "direct" and the case law, the Indiana supreme court held that the "direct loss" requirement is satisfied by demonstrating that the loss resulted either "immediately or proximately without significant deviation from the use of a computer." The court found, based on the insured's specific actions that the insured's payment of bitcoin "was nearly the immediate result - without significant deviation, from the use of a computer." The court also rejected the insurer's position that the payment was "voluntary" reasoning that the "voluntary" payment was not so remote from the event. The insureds would have incurred even greater loss if the payment was not made, and therefore, the payment was made under duress. Finally, the court addressed the requirement under the computer fraud provision that the ransomware attack constitute "fraudulent" conduct. According to the court, the term "fraudulently cause a transfer" means "to obtain by trick." Applying this definition to the facts of the case, the court found that there is a question as to whether the insured's computer systems were accessed by trick, and therefore, remanded the case back to the trial court for further proceedings. *G&G Oil Co. of Ind. V. Cont'l W. Ins. Co.*, 2021 Ind. LEXIS 182 (Ind. 2021).

Privilege Protections for Cyber Forensic Reports Continue to Face Significant Challenges

The United States District Court for the District of Columbia addressed the privilege protections often asserted by an organization following a cyber-attack. In the latest decision on this topic, the court further narrowed the availability of asserting privilege defenses to cyber forensic reports.

A former client of a law firm ("firm") sued the firm for failing to protect his confidential information after a hacker stole the client's data from the firm's systems. During the discovery process, the firm declined to provide documents prepared by one of its two external security-consulting companies. The firm, through its outside cybersecurity counsel, objected on two grounds – the "attorney work-product doctrine" and the "attorney-client privilege." In support, the firm argued that certain materials were protected from discovery because it had initiated a "two-track" investigation into the breach, an approach sometimes used by companies following security incidents.

More specifically, the firm claimed the first track was a non-privileged investigation into the breach (ordinary course of business), and the second track was an investigation for legal purposes -- and that materials prepared on the legal track were protected from discovery (by the work-product doctrine, and also by the attorney-client privilege). The firm acknowledged that its usual retained cybersecurity vendor's report was discoverable, but conversely argued that doctrines applied to bar disclosure of the cybersecurity vendor retained by the firm's outside cybersecurity counsel. However, in rejecting the law firm's arguments, the court noted that the firm did not provide testimony confirming that its ordinary-course-of-business vendor conducted a separate investigation, much less did the firm provide any evidence that its ordinary business vendor produced any of its own findings. Instead, the court suggested that the two tracks were blurred and pointed to the fact that the report created on the legal track was the only comprehensive report produced, that it included subject matter related to business continuity, such as remediation actions, and that it was distributed to outside and inside counsel, select members of the firms leadership and IT team, and the FBI for a variety of legal and non-legal purposes.

After analyzing and rejecting the applications of the work-product doctrine and attorney-client privilege, the court ordered the disclosure of the report generated by the cybersecurity vendor retained by the firm's outside cybersecurity counsel. *Wengui v. Clark Hill, PLC*, 2021 U.S. Dist. LEXIS 5395 (D. D.C. 2021).

Court Dismisses Purported Class Action for Lack of Standing in Data Breach Case

Following a ransomware attack, the United States District Court for the Eastern District of Pennsylvania found that the plaintiff lacked Article III standing under the United States Constitution to bring her claims.

The affected company fell victim to a ransomware attack, wherein the threat actor accessed thousands of individuals' sensitive information, including names, home addresses, social security numbers, taxpayer IDs, and credit card and bank information. The threat actor demanded a ransom, and also made some of the data stolen available on the "dark web." Following the attack, the affected company offered free identity monitoring services to all potentially affected current and former employees.

The plaintiff, a former employee, commenced suit on behalf of herself and all others similarly situated, alleging that her personal information was shared on the dark web. Plaintiff further alleged that she purchased additional credit monitoring services for herself and her family at a cost of $39.99 per month, and "spent significant time and effort reviewing her financial accounts, bank records, and credit reports for unauthorized activity and will continue to do so." She moreover alleged stress and anxiety caused by the breach.

The affected company filed a motion to dismiss the complaint, arguing in large part that plaintiff lacked Article III standing to bring her claims. The court explained that to demonstrate standing under Article III, a plaintiff must establish: (1) she suffered an injury-in-fact; (2) the injury is fairly traceable to the challenged action of the defendant; and (3) it is likely, as opposed to speculative, that the injury will be redressed by a favorable decision." The court, in rejecting the plaintiff's claims, noted prior case precedents in the controlling Circuit holding that "in the event of a data breach, a plaintiff does not suffer a harm, and thus does not have standing to sue, unless plaintiff alleges actual 'misuse' of the information, or that such misuses is imminent." Accordingly, the court found plaintiff's claims speculative, and dismissed the complaint. *Clemens v. ExecuPharm, Inc.*, 2021 U.S. Dist. LEXIS 35178 (E.D. Pa. 2021).

Class Action Filings

Source – Stanford Law School, Securities Class Action Clearinghouse

Q1 2021

Filing Name	Filing Date	District Court
9F Inc. : American Depositary Shares	1-20-2021	D. New Jersey
Aerojet Rocketdyne Holdings, Inc.	1-29-2021	C.D. California
AgEagle Aerial Systems, Inc.	2-26-2021	C.D. California
Allianz Global Investors U.S. LLC : Alpha Funds	1-21-2021	S.D. New York
Anworth Mortgage Asset Corporation	1-21-2021	C.D. California
Apache Corporation	2-23-2021	S.D. Texas
Aquestive Therapeutics, Inc.	3-1-2021	D. New Jersey
Astrazeneca PLC : American Depositary Shares	1-26-2021	S.D. New York
Athenex, Inc.	3-3-2021	W.D. New York
BELLUS Health Inc.	3-16-2021	S.D. New York
Bit Digital, Inc.	1-20-2021	S.D. New York
bluebird bio, Inc.	2-12-2021	D. Massachusetts
Boston Private Financial Holdings, Inc.	3-15-2021	N.D. California
Change Healthcare Inc.	3-19-2021	N.D. California
CleanSpark, Inc.	1-20-2021	S.D. New York
Clover Health Investments, Corp.	2-5-2021	M.D. Tennessee
CoreLogic, Inc.	3-29-2021	C.D. California
CytoDyn Inc.	3-17-2021	W.D. Washington
Decision Diagnostics Corp.	1-15-2021	C.D. California
Ebix, Inc.	2-22-2021	S.D. New York
EHang Holdings Limited : American Depositary Shares	2-17-2021	S.D. New York
Exxon Mobil Corporation	1-28-2021	N.D. Texas
FuboTV Inc.	2-17-2021	S.D. New York
GigCapital3, Inc.	2-8-2021	N.D. California
GTT Communications, Inc.	1-12-2021	C.D. California
GW Pharmaceuticals plc : American Depositary Shares	3-26-2021	S.D. California
Immunovant, Inc.	2-19-2021	E.D. New York
Infinity Q Capital Management, LLC : IQDAX and IQDNX shares	2-26-2021	E.D. New York
Inphi Corporation	1-20-2021	N.D. California
iRhythm Technologies, Inc.	2-1-2021	N.D. California
Jianpu Technology Inc. : American Depositary Shares	2-17-2021	S.D. New York
Leidos Holdings, Inc.	3-4-2021	S.D. New York
Lizhi Inc. : American Depositary Shares	1-20-2021	E.D. New York
Lordstown Motors Corp.	3-18-2021	N.D. Ohio
MDC Partners Inc.	3-11-2021	C.D. California
MML Investors Services, LLC : GME shares	2-16-2021	D. Massachusetts
MoneyGram International, Inc.	3-1-2021	C.D. California
MultiPlan Corporation	2-24-2021	S.D. New York
Nantkwest, Inc.	2-16-2021	S.D. California
Nelson Partners, LLC : NP Skyloft, DST	2-25-2021	C.D. California
Neos Therapeutics, Inc.	2-9-2021	S.D. New York
Neptune Wellness Solutions Inc.	3-16-2021	E.D. New York
NIC, Inc.	3-30-2021	D. Delaware
Nielsen Holdings PLC	1-15-2021	C.D. California
NTN Buzztime, Inc.	1-28-2021	S.D. California
Ontrak, Inc.	3-3-2021	C.D. California
Penumbra, Inc.	1-15-2021	N.D. California
Plug Power Inc.	3-8-2021	S.D. New York
QuantumScape Corporation	1-5-2021	N.D. California
Range Resources Corporation	3-4-2021	W.D. Pennsylvania

Class Action Filings

Q1 2021 Continued

Filing Name	Filing Date	District Court
RealtyShares, Inc. : Debt Securities	2-26-2021	D. Massachusetts
Renewable Energy Group, Inc.	3-2-2021	S.D. New York
Repro Med Systems, Inc.	3-26-2021	S.D. New York
Robinhood Financial, LLC	1-29-2021	S.D. Florida
Root, Inc.	3-19-2021	S.D. Ohio
S&P Global Inc.	2-1-2021	N.D. California
Sequential Brands Group, Inc.	3-16-2021	C.D. California
Slack Technologies, Inc.	1-7-2021	N.D. California
SolarWinds Corporation	1-4-2021	W.D. Texas
SOS Limited : American Depositary Shares	3-30-2021	D. New Jersey
Sportsman's Warehouse Holdings, Inc.	2-24-2021	N.D. California
Sunesis Pharmaceuticals, Inc.	1-8-2021	N.D. California
TeleNav, Inc.	1-21-2021	N.D. California
Tricida, Inc.	1-6-2021	N.D. California

Filing Name	Filing Date	District Court
Tyson Foods, Inc.	2-2-2021	E.D. New York
Velodyne Lidar, Inc.	3-2-2021	N.D. California
Voyager Therapeutics, Inc.	1-22-2021	E.D. New York
Vroom, Inc.	3-22-2021	S.D. New York
Waddell & Reed Financial, Inc.	2-24-2021	N.D. California
Walmart Inc.	1-20-2021	D. Delaware
Workhorse Group, Inc.	3-8-2021	C.D. California
Xilinx, Inc.	1-15-2021	N.D. California
XL Fleet Corp.	3-8-2021	S.D. New York
Zagg Inc	1-14-2021	S.D. New York

Key Contacts

Jacqueline A. Waters, Esq.
Managing Director & Practice Leader
Financial Services Group | Legal & Claims Practice
Commercial Risk Solutions, Aon
312.381.4563
jacqueline.waters@aon.com

Robbyn S. Reichman, Esq.
Managing Director & Practice Leader
Financial Services Group | Legal & Claims Practice
Commercial Risk Solutions, Aon
212.441.2309
robbyn.reichman@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.