

TRENDS IN DIRECTORS AND OFFICERS (D&O) INSURANCE NDI Panel November 2019

Where D&O Market Currently is From a Cost / Premium / Claims Standpoint

- ***Big Picture Issues Driving Price Increases in D&O Insurance Rates***
 - There are fewer publicly traded companies, yet securities class action filings continue to soar. The rate of litigation in 2018 was 8.7%, an all-time high.
 - Claims costs continue to increase; continued innovation by the plaintiffs' bar.
 - Management liability (specifically D&O) premiums hit an all-time low and down over 74% since 2003.
 - There is profit pressure on insurers to push for higher rates. Historical mispricing has created a significant hole in D&O reserves.
 - Total value of 2018 settlements was \$5.064 billion, which was 50% higher than the annual average for the prior nine years.
 - There are follow-up suits to Event Driven Litigation (EDL) / EPLI issues at the boardroom level leading to more securities class actions and derivative claims.
 - Securities class action lawsuits are long-tail claims:
 - Typically, securities class actions last anywhere from two to four years, with some lasting even longer.
 - From 1997 to 2017, 50% of filings settled, 43% were dismissed, and 6% are ongoing.
 - Overall, less than 1% of filings reached a trial verdict.
- ***Factors Impacting the Market's Premium Trends***
 - DJIA, S&P 500 and Nasdaq Index at all-time highs.
 - Corporate valuations are getting bigger.
 - The total value of 2018 settlements (mentioned above).
 - Management liability premiums hit an all-time low (mentioned above).
 - Claims frequency is currently two times the historical average.

- Probability of being sued is nearing 10%.
- ***Heat Map/Claims Trend***
 - Federal Class Action Filings Summary
 - Plaintiffs filed 403 new federal securities class actions in 2018, making it the second-largest year on record, trailing only 2017.
 - The number of filings in 2018 was 99% higher than the 1997 to 2017 average.
 - The 182 M&A filings in 2018 were the second-largest number since 2009 and remain the primary contributor to the total increase.
 - Core filings—those excluding M&A claims—were the highest since 2008, when filings surged due to the volatility in U.S. and global financial markets.
 - The likelihood of core filings targeting U.S. exchange listed companies surpassed the previous record set in 2017.
 - The likelihood that U.S. exchange listed companies were subject to core filings increased for a sixth consecutive year, from 2.6% in 2012 to 4.5% in 2018.
 - Approximately 1 in 22 companies listed on U.S. exchanges was the subject of a core filing in 2018.
 - Including M&A filings, a record 8.4% of U.S. exchange listed companies were subject to filings in 2018, slightly above the rate in 2017.
 - Overall, the probability of a U.S. exchange listed company being subject to a securities lawsuit remained at a record level of nearly 1 in 12.

“Hot Topics”

- ***M&A claims***
 - Merger Objection Cases
 - In 2016, the Delaware Chancery court in the *Trulia* decision held that Delaware would not award significant attorneys’ fees in cases that resulted in a “disclosure only” settlement in merger objection case.

- Nearly overnight, those cases previously filed in Delaware state courts migrated to federal court.
- *Derivative Claims Activity*
 - A potential concern for directors and officers is the rise of non-indemnifiable claims. Derivative lawsuits are an important proxy for non-indemnifiable claims, as (with some exceptions), derivative settlements are non-indemnifiable.
 - While derivative claims are by nature relatively opaque, it is clear that the number of derivative claims filings has risen since 2011.
 - Many derivative claim settlements are large in nature, with several recent examples in excess of \$100 million. Several of the large settlements could be considered a part of the EDL phenomena.
 - The combination of rising derivative action frequency plus large derivative claim settlements, foreshadows an increasing concern for potential increased personal liability for corporate leaders.

Public vs. Private Companies

- *Public Companies*
 - The underlying consolidation of the number of public companies through acquisitions/mergers has had the obvious effect of decreasing the number of public companies. There are fewer publicly traded companies today that previously.
 - When considering the 403 federal securities class actions filed in 2018 and the shrinking number of public companies; it is evident that public companies today have a proverbial target on their backs.
 - At year-end 2017, there were slightly more than 3,600 U.S. publicly traded companies. Contrast that number with the number of class action securities cases filed against publicly traded companies in 2018; nearly 8.5% of all publicly traded companies were sued in securities class action in 2018. Notably, this is the highest since 2006, when the average annual litigation for 1996 to 2016 was 2.9%.
- *Private Companies*
 - More than 1 in 4 (26%) of private companies reported experiencing a D&O loss in the last three years.

- What private company D&O claims look like:
 - Customer: sues the company and/or Directors and Officers.
 - Competitor: sues the company and/or Directors and Officers.
 - Partner or Other Shareholder: sues the company and/or Directors and Officers.
 - Vendor or Supplier: sues the company and/or Directors and Officers
 - Government Agency: sues the company and/or Directors and Officers.
 - Director or Officer: is sued in connection with the purchase or sale of any equity or debt securities.

Unfavorable Court Decisions for Insurers and Impact on Costs of Defending Claims

- ***Impact of Cyan decision***
 - Following the U.S. Supreme Court's decision in *Cyan*, which held that state courts have concurrent subject matter jurisdiction over class actions that exclusively allege claims against the Securities Act of 1933, an open question remained as to whether the Private Securities Litigation Reform Act of 1995's (PSLRA) automatic stay on discovery applied during the pendency of a motion to dismiss in state court. Over one year since the *Cyan* decision, the PSLRA's automatic stay provision's applicability remains an open question—as states have come to differing conclusions.
 - California was one of the first state courts to opine on the issue. The California Court held that PSLRA's provision for a discovery stay is a procedural nature and only applies to actions in federal court not state. *Switzer v. W.R. Hambrecht & Co.*, 2018 Cal. Super. LEXIS 2429 (Cal. Super., 2018).
 - On the other hand, in a Connecticut case, the court ultimately concluded that the PSLRA's discovery stay subsection applies to actions pending in state court as well as federal. *City of Livonia Retiree Health and Disability Benefits Plan v. Pitney Bowes, Inc.*, 2019 Conn. Super. LEXIS 1604 (Conn. Sup. Ct., 2019).
 - The lack of uniformity as to the PSLRA's automatic discovery stay will present practical and financial issues for litigants facing claims in state court under the Securities Act.

Cyber-Related Liability / Event Driven Litigation

- ***Cyber-Related Liability***

- While historical perspective may suggest that cyber risk was predominately a personally-identifiable information risk, more recent developments provide examples of business interruption losses streaming from cyber risk, which additionally manifests in claims relating to regulatory responses and shareholder litigation. The combination of those emerging developments is increasingly relevant to corporate boards and leaders, as the nature of cyber risk grows and evolves.
- The escalating nature of cyber risk can be segmented into two trends:
 - First, the number of cyber incidents is increasing—the frequency of significant incidents has grown nearly eight-fold since 2012.
 - Second, the reliance of businesses upon technology and the Internet is growing.
- The combination of these two trends can be significant and can include reputational harm, financial loss, and legal costs.

- ***Recent Event Driven Litigation Examples***

- FedEx: Failure to fully disclose the extent of the disruption at its European operation after it was hit with the NotPetya malware virus in June 2017.
- Vale: Brazilian dam collapse Marriott International Data breach of personal information involving 327 million guests.
- Boeing: Lion Air Flight 610 / 737 Max.
- Pacific Gas and Electric: Derivative lawsuit in federal court relating to their alleged role in causing the Camp Fire. PG&E then filed for Chapter 11 bankruptcy on January 29, 2019.
- Edison International: California Wildfires.
- Nike, Inc.: “Boy’s Club” culture of sexual harassment and bullying.
- Alphabet: Failed to disclose software glitch in Google+ website that permitted third parties to access personal data of half a million users.
- Facebook, Inc.: Cambridge Analytica / Privacy Violations / GDPR.

- Papa John's Int'l: Pattern of sexual harassment and other inappropriate workplace conduct, including its founder.
- CBS: Les Moonves sexual harassment/misconduct situation.
- Johnson & Johnson: Reports alleging that talc increased risk of ovarian cancer.
- Wynn Resorts: Dozens of allegations of sexual misconduct involving Steve Wynn.
- RYB Education: Video footage of alleged child abuse at company preschool facilities.
- Twenty First Century: Sexual harassment scandal (Roger Ailes and Bill O'Reilly); settled for \$90 million.
- SCANA Corporation: Failed nuclear project / lack of disclosure.
- Equifax Inc.: Data breach of personal information involving 143 million Americans.
- Arconic Inc.: Grenfell Tower fire.
- Anadarko Petroleum: Home explosion / well closures.
- Yahoo Inc.: Data breach affecting all 3 billion of Yahoo's user accounts; settled (SCA: \$80 million; derivative: \$29 million).