Corporate Governance and SEC Update

SEC Enforcement/Securities Litigation and D&O Insurance

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Recent SEC Enforcement Developments

- Change in SEC policy regarding "no admissions" settlements
  - SEC Chair Mary Jo White has joined with colleagues at DOJ to change the perception that U.S. companies are "too big to jail"
  - SEC has made it a priority in "egregious" cases to require admissions of liability
- Recent settlements:
  - SAC: agreed to plead guilty to insider trading violations and pay a $1.2 billion penalty
  - JP Morgan: $200 million penalty in the London Whale case, coupled with JPM admissions of the facts underlying the SEC's charges, and a public acknowledgement that JPM violated the federal securities laws

Recent SEC Enforcement Developments

D&O insurance implications of new SEC "admissions" policy

- Could force more cases to "go the distance" because of adverse consequences in other civil litigation and future disclosure requirements, eroding limits to cover related D&O litigation matters
- Admissions could implicate conduct exclusions
- Raises specter of recoupment action by D&O carrier for past defense costs

Recent SEC Enforcement Developments

SEC Whistleblower Bounty Awards

- 2012 saw over 3,000 tips reported to the SEC
- Fully funded SEC - over $450 million fund is available to pay awards
- Two significant awards in October 2013 – more than $14 million in one case, $150,000 in another
- SEC is signaling this is the tip of the iceberg; now that the Whistleblower Program has been in place for over two years, more rewards are expected

Recent SEC Enforcement Developments

D&O insurance implications:

- Increase in the number of SEC investigations involving individual Ds and Os and the corporate entity
- Increase in shareholder litigation: Follow on derivative and securities class action suits arising out of SEC investigations prompted by whistleblower reports
  - *Unilife* case in Tennessee following a retaliation suit by a terminated employee
- Traditionally Entity coverage is not available for formal investigations brought by SEC or DOJ – new products and endorsements are being developed by insurers to address these investigations

M&A Class Action Litigation

- Claims frequency has dramatically increased:
  - 2007: 21% of deals over $100 million, and 57% over $500 million drew M&A class action suits
  - 2012: 52% > $100 million and 96% > $500 million
- 72% of deals drawing litigation have suits in more than one jurisdiction
- Case outcomes:
  - About one-third are dismissed through litigation
  - The remaining two-thirds of these claims settle, usually based on additional disclosures or corporate governance reforms
- Average fee award - $500K to $600K

M&A Class Action Litigation (cont'd)

- Insurance industry reaction to increased M&A class action filings
  - Increased inquiries and underwriting in highly acquisitive industries
  - Separate M&A retentions now included on many D&O policies
  - Plaintiff attorneys' fees are typically not covered costs in a D&O policy

Dodd-Frank "Say-on-Pay" Fallout

- 1st litigation wave in 2011
  - Derivative actions challenging boards' decisions to approve executive compensation plans in the face of negative say-on-pay votes
- 2nd wave in 2012
  - Plaintiffs filing suits challenging proxy disclosures relating to both say-on-pay votes
- 3rd wave in 2012 and 2013 – Equity Incentive Plan proxy disclosure challenges
  - Alleging stock options awarded to executives are in violation of or in excess of, what is permitted under equity incentive plans
  - Inadequate and/or misleading disclosures in their proxy statements – claims that the company did not provide a "fair summary" of plan provisions and projections concerning future stock grants