

# But What If We Flame Out? Trends in D&O Coverage of Particular Importance to Emerging Companies and their Insurers

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# D&O Trends Affecting Emerging Companies

Competitive landscape for startups and emerging technology companies:

- Pressure to grow quickly
- Calls for rapid, stunning growth
- Competition for next “unicorn” – privately-held \$1 Billion startup
- Investor expectations of exponential returns over lasting results
- Representations and filings regarding projected returns
- Trade secret protections
- Cybersecurity/Data security concerns
- Regulatory investigations
- Ransomware issues
- Etc.

# D&O Trends Affecting Emerging Companies

## “Traditional” Claims facing startups:

- Securities Class Actions/Derivative Suits
  - Breach of Fiduciary Duty (care, loyalty, self-dealing)
  - Misrepresentation claims
  - Derivative Suits
- Section 220 Books & Records demands
- Appraisal actions
- Merger & Acquisition/Going Private issues
  - Inadequate compensation issues vs. adequate but objectionable
- Cyber-related suits and investigations
- Trade secret/Lanham Act claims
- Product disparagement/advertising
- EPL/FLSA claims

# D&O Trends Affecting Emerging Companies

Becoming “more traditional” and needing coverage (pending Administration changes, if any):

- Dodd Frank/Consumer Fraud Protection Bureau (CFPB)
  - Enforcement Actions
  - E.g., Dwolla 2016 Enforcement Action (misrepresenting data security practices and security of its online payment system despite no breach - \$100,000 )
- Telephone Consumer Protection Act (TCPA)
- Governmental investigations: accounting/representations/cyber breaches
- Qui Tam/Whistleblower actions
- False Claims Act actions
- Fiduciary Liability issues: Settlor Liability
- Crime issues:
  - Social engineering
  - Fraudulent impersonation
- Government funding issues (nonprofit/minority-owned businesses)

# Claim Trends Affecting Emerging Companies

- What brokers are seeing in the market:
  - SEC Investigations and Enforcement Coverage
    - Entity Coverage
  - Merger Objections
  - Focus on coverage for regulatory investigations
  - Derivative Investigation Costs
    - Sublimited coverages/drop down excess
  - Coverage for Section 220 Books & Records
    - Increased interest re exhaustion of inquiries before suit
  - Appraisal actions
  - Cyber activities

# Claim Trends Affecting Emerging Companies

- What we are seeing in the market:
  - Cyber/Bitcoin/FinTech/Insure Tech issues
  - Increased Defense costs
  - Plaintiffs' Attorneys' Fees
  - Late Notice/"Material Prejudice" inquiries
  - New definitions (Definition of "Claims," etc.)
  - Shaving of Limits issues
  - Multi-national claims
  - Enhanced Side A policies and increased limits
  - Evolution of new products (excess/drop down)
  - Coordination of Coverage/ "Relatedness" issues

# D&O Trends Affecting Emerging Companies

## Recent Trends of Interest

# D&O Trends Affecting Emerging Companies

- Predictions: Shareholder class actions and other securities suits are alive and well in 2017, and are expected to increase in number.
- Surge of merger objection class actions, cyber security, follow-ons and international actions.
- Third party litigation spending hits all time high.
- 90%+ figure for M&As resulting in shareholder litigation per Cornerstone Research

## THE D&O DIARY

A PERIODIC JOURNAL CONTAINING ITEMS OF INTEREST FROM THE WORLD OF DIRECTORS & OFFICERS LIABILITY, WITH OCCASIONAL COMMENTARY

### Record Setting Securities Suit Filing Pace Accelerates Into New Year

By Kevin LaCroix on January 29, 2017  
POSTED IN SECURITIES LITIGATION



As the various annual securities suit filing reports have been coming out, it has become clear that federal securities class action lawsuit filings were at record levels in 2016, largely as a result of a rise of merger objection lawsuit filings in federal court. Now that 2017 is well underway, it is clear that the heightened pace of securities suit filing has continued, and arguably even accelerated, in the New Year.

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# D&O Trends Affecting Emerging Companies

Filings on January 27, 2017 alone show continuing pace of new filings, with six reported federal court securities class action filings:

- Federal court merger objection class action lawsuit (D. Minn.) against Vascular Solutions and certain directors and officers;
- Traditional securities class action lawsuit (C.D. Cal.) against Gigamon and certain executives;
- Traditional securities class action lawsuit (E.D. Penn) against Egalet, Inc. and certain directors and officers;
- Federal court merger objection lawsuit (D. Colo.) against Stillwater Mining and certain directors and officers;
- Federal court merger objection lawsuit (D. Del.) against Universal American Corp. and certain executives; and
- Traditional securities class action lawsuit (N.D. Cal.) against State Street Corp. and certain directors and officers.

# D&O Trends Affecting Emerging Companies

April 2016, SEC announced a “[Silicon Valley Initiative](#)” that showed increased concerns at the regulatory level about private companies scoring tremendous valuations in private offerings.

- Focus on so-called “unicorns” (private companies with valuations greater than \$1 billion).
- Comments by the SEC Chairman Mary Jo White highlight concerns at the Rock Center for Corporate Governance at Stanford.
- SEC emphasizing that although the SEC encourages capital formation for innovative Bay Area companies because they are so critical to our economy and markets, the SEC expects companies to embrace and demonstrate sound corporate governance and financial controls.

# D&O Trends Affecting Emerging Companies

SEC Chairman posed questions that directors, advisors and pre-IPO companies should be asking:

- Does board include outsiders with public company or large company experience?
  - Does board members have regulatory and financial experience?
  - Does board have sufficient industry expertise to analyze different viewpoints and spot critical issues?
  - Is the company run and governed for the benefit of all of its investors?
- *E.g.*, Marrone Bio Innovations, Inc. (charges against the company and a former executive in February 2016 for inflating financial results in order to meet projections for first year as a public company, and insufficient internal controls allowing false documentation)

# D&O Trends Affecting Emerging Companies

## Recent Cases of Interest

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## SEC and DOJ Investigations

- *Partner Investments, L.P., et al. v. Theranos, Inc., et al.*, DE Ch. Ct CA 12816-VCL
- *Robert Colman, et al. v. Theranos, Inc. et al.*, Case No. 5:16-cv-06822-NC, U.S. Dist. Ct, ND CA



# Recent Cases of Interest

- *Theranos*

Biotech with “finger prick” blood-testing technology with start-up valued at \$9 billion

- Class action alleges that core technology was faulty and that Theranos administered its blood tests using competitors’ equipment
- Theranos CEO is banned from operating a laboratory
- Theranos’ President and COO is leaving
- Congressional inquiry seeking explanation
- Theranos is facing class action lawsuit accusing it of consumer fraud
- Derivative suits?
- Investigations per public reports:
  - US Centers for Medicare and Medicaid Services
  - Department of Justice
  - Securities & Exchange Commission (accuracy of company’s disclosures to investors)

# Recent Cases of Interest

“While the rise and fall of Theranos has been dramatic, it is far from a rare case. In fact, it illustrates the perverse incentives faced by every startup in the Silicon Valley. As bad as these incentives are for investors, the might be even worse for consumers.”

“But it takes time to build a sustainably profitable business, and Valley investors want rapid, stunning growth. In the search for the next “unicorn” ... investors prioritize exponential returns over lasting results.”

J. Edelson & C. Dore, *Theranos Exposes the Perverse Incentives at Work in Silicon Valley*  
<https://qz.com/673442/theranos> etc. (visited 1/20/17) (authors are members of plaintiffs' bar)

## Recent Cases of Interest

- *In re Dole Food Company Inc. Stockholder Litigation*, Civil Action No. 8703-VCL, Delaware Chancery Court
- *Arch Insurance Company, Liberty Mutual Insurance Company, Continental Casualty Insurance Company, Navigators Insurance Company, RSUI Indemnity Company and Berkley Insurance Co. v. David H. Murdock, C. Michael Carter, Dole Food Company, Inc. and DFC Holdings, LLC*, Case No. N16C-01-194 EMD CCLD (Del. Superior Court, Motion to Dismiss decided Dec. 21, 2016)



# Recent Cases of Interest

## *Arch v. Dole* (coverage case)

- Insurers filed declaratory relief action against individual D&Os and Company, seeking declaration that insurers do not have to fund a settlement due to alleged fraud, or seeking to subrogate against insured per the exclusion.
- Shareholder action alleged that defendants engaged in lengthy process to manipulate stock price so that owner and CEO Murdock could acquire stock at lower price in going private transaction.
- After Vice Chancellor issued Memorandum Opinion with explicit findings, the defendants settled and sought reimbursement, focusing on final adjudication language of the dishonesty exclusion.
- The Court held:
  - The Memorandum Opinion, outlining the Defendants' misconduct – was a step towards a final adjudication. That decision alone was not final and was not appealable.

# Recent Cases of Interest

“The language [of the exclusion] is not complicated. If a deliberate act of fraud by an insured is determined through a final and non-appealable adjudication, the Insurer will not be responsible for any claim made by that insured related to the adjudicated fraudulent act. [¶] The court does not find the language of the exclusions to be ambiguous. The Memorandum Opinion, without more (i.e., a Chancery Rule §4(b) entry of judgment or a Chancery Rule 58 order) was not a final and non-appealable adjudication adverse to such insured in the underlying action. The only final and non-appealable adjudication in the Chancery Court action was the Order and Final Judgment. Accordingly, Exclusion IV.A.6 does not apply to the facts of this case.”

# Recent Cases of Interest

“While this Court does believe that Vice Chancellor Laster did make findings that some of the Defendants ... committed fraudulent acts, the Memorandum Opinion was not a final and non-appealable adjudication. ....”

# Recent Cases of Interest

- *Onyx Pharmaceuticals, Inc. v. Old Republic Insurance Co., RLI Insurance Co., Allied World Assurance Company (U.S.) Inc. and Berkley Insurance Co.*, San Mateo County Superior Court (CA), Case No. CIV 538248, filed April 18, 2016

# Recent Cases of Interest

## *Onyx Pharmaceuticals:*

- Certain officers and directors of Onyx were sued in August 2013 in *In re Onyx Pharmaceuticals, Inc. Shareholder Litigation* (San Mateo County Superior Court)
  - Underlying claims against Board members alleged for breach of fiduciary duty in connection with the sale of Onyx to Amgen for a “premium price” of \$125/share.
  - After two years of discovery, the Consolidated Amended Class Action Complaint asserted a single claim for the Breach of Fiduciary Duties of Loyalty and Good Faith against all defendants alleging failure to maximize value of Onyx stock, failure to protect shareholders against multiple conflicts of interest, agreeing to allegedly unreasonable preclusive deal protections, and failing to disclose material facts.
- Primary insurer National Union agreed to pay limits of \$10M for defense costs and settlement;
- Excess follow-form insurers denied coverage, based on “Bump Up” exclusion;
- Gravamen of the case: Board did not achieve best price vs. inadequate price.

# Recent Cases of Interest

- *Yahoo! Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*, Case No. 5:17-cv-00447 (USDC, N.D. Cal., San Jose Div.), filed Jan. 27, 2016 (CGL Policy)

## Shareholder Files Data Breach Securities Class Action Lawsuit Against Yahoo

By Kevin LaCroix on January 25, 2017

POSTED IN CYBER LIABILITY

**YAHOO!** I wouldn't ordinarily write about the same company or set of circumstances two days in a row, but because of developments following in the wake of the data breaches Yahoo announced last year, the company's name has come up again. Yesterday, I wrote about the investigation the SEC reportedly is pursuing in connection with Yahoo's alleged delays in disclosing the data breaches. It turns out that yesterday a plaintiff shareholder also filed a securities class action lawsuit in the Northern District of California against Yahoo and certain of its directors and officers relating to the company's reported data breaches. A copy of the complaint the plaintiff filed on January 24, 2017 can be found [here](#).

As I noted yesterday, and as discussed in detail [here](#), Yahoo announced two data breaches during 2016. The first, which Yahoo announced in September 2016, took place or at least began sometime during 2014, and resulted in hackers obtaining data from over 500 million user accounts. A separate data breach, which apparently took place or

# Recent Cases of Interest

- **Second Coverage Lawsuit:** *Yahoo! Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*, (USDC, N.D. Cal., San Jose Div.), filed Jan. 31, 2016 (also CGL Policy)

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# Potentially Problematic Exclusions and Issues

- Potentially Problematic Exclusions and Issues:
  - So-Called Dishonesty Exclusions:
    - Deliberate criminal or deliberate fraudulent conduct
    - Personal profit/Financial advantage
    - Professional Errors/Omissions
      - But not failure to supervise those who perform or failed to perform professional services or Securities Claims
    - Final Adjudication standard
  - Inadequate Compensation (aka “Bump Up”) Exclusions
  - “Loss” – Disgorgement and Restitution
  - Capacity arguments ( “.... acting in the capacity as such ...”)
  - Related Claims
  - BI/PD/Right of Privacy Exclusions (“bodily injury, violation of any right of privacy, mental anguish, ... provided” exclusion not apply to Securities Claim)
  - Section 533 Intentional conduct arguments

# D&O Trends Affecting Emerging Companies

## Additional Tips:

- Side A Purchases
- Pre-purchase audits to avoid language issues
- Protecting The Record/Protecting Coverage
  - Responses to Reservation of Rights Letters
  - Prompt notice/all stages
  - Addressing Allocation
  - Consent
    - Voluntary Payments
    - Selection of Counsel
    - Disparate Positions & Concerns
- Qualcomm Exhaustion/Fill issues (Side A)
- Privilege issues