Derivative Settlements Trend Higher, Side-A Coverage Becomes Crucial

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Introduction

Side-A Directors and Officers liability insurance helps to protect directors and officers in situations when the company they serve does not, cannot or refuses to indemnify them, such as in an insolvency situation or due to prohibitions by law. An example of such prohibition would be the monetary settlement of a derivative case, which is non-indemnifiable in many jurisdictions, notably including Delaware, where more than half of America's publicly traded companies are incorporated. Derivative lawsuits are a tool through which shareholders can stand in the shoes of the company and seek to hold directors and officers accountable for alleged wrongdoing. In the early 2000's, derivative actions were afterthoughts and were considered "tag-alongs" to securities class actions and generally settled on non-monetary terms, such as changes to corporate governance or amended disclosures.

Shifting Winds

Much has changed in the years since - it is now rare to see a securities class action without an accompanying derivative lawsuit, and additionally, derivative lawsuits are more frequently filed without a companion securities class action. Although the data is somewhat limited, enough publicly reported derivative settlements exist to take notice that we are no longer

only dealing with derivative actions that involve non-monetary settlements and defense cost only exposure, which pose a more limited need for Side-A insurance. As the times have changed, so must the calculus for what constitutes adequate protection for for directors and officers of publicly traded companies.

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In review of derivative settlements from 2019 forward, including *Tesla* which settled in July 2023, at least 11 lawsuits have settled for amounts in excess of $100 million. Additionally, if we focus only on the top 10 derivative settlement amounts over the prior two decades, nine have been in the past four years. While the universe of derivative settlements including monetary components is relatively small when compared to traditional securities class actions, the magnitude of such settlement amounts can be quite large. It would be incorrect to assert that shareholders did not seek to hold directors and officers accountable for wrongdoing prior to 2019. Clearly that was happening, however, a shift has taken place since 2019 and it is worth examining.

Analyzing the cohort of derivative settlements over the course of the past four years, what kind of sense can be made from a corporate liability standpoint and an insurance perspective? Are directors and officers breaching their duties of loyalty and care to the company more frequently now than in years past, or rather, are shareholders less tolerant of decisions

and actions they view as harmful to the company? To opine on those broader questions goes beyond the scope of this discussion but contemplating them does help to illuminate a trend - shareholders are more actively pursuing claims which are, at their core, arising from perceived harm to the company's employees, customers, or the public at large. Some commentators have referred to this as "event driven" shareholder litigation. There is also attention, particularly in Delaware litigation, on mergers, acquisitions and transactions driven by controlling shareholders. Thus, the cluster of cases over the past several years driving these trends do appear different than their predecessors, which largely focused on financial, accounting and merger-related issues.

A Pattern Emerges

Wells Fargo was one of the first derivative settlements of this modern era which included a very large monetary settlement. *Wells Fargo* involved a sales practices scandal arising from a corporate strategy that incentivized employees for the opening of new bank accounts, which resulted in the creation of as many as 2.1 million deposit and credit card accounts using fictitious or unauthorized customer information. The settlement had a stated value of $320 million, inclusive of a cash payment of $240 million. Notably, the cash portion was exactly 50 percent of the securities class action settlement and was touted as the largest ever insurer-funded cash component of a derivative settlement. The *Wells Fargo* case appears to have whetted the appetite of shareholders and plaintiffs' counsel, to seek vindication of harm to their company, and was closely followed by a $310

million derivative settlement by *Alphabet/Google* related to the alleged covering up of sexual misconduct by executives. The *Alphabet* settlement is notable insofar as the $310 million component was in the form of a fund that would be used to implement governance reforms which were agreed upon as part of the settlement. Interestingly, the $310 million was not funded by insurance, but the associated $40 million plaintiff's fee award was. *Alphabet* prompted at least two copycats: *L Brands*, which settled for $90 million; and *Pinterest*, which settled for $50 million.

Next, we turn to *McKesson*, which attracted a derivative lawsuit resulting from its role as a major distributor of opioids. This settlement is notable not only for its size - $175 million – but also because of its status as a standalone derivative case - there was no stock drop, nor was there a securities class action. A common thread is that the underlying wrongful acts in these cases received a significant amount of publicity, and these companies were under significant pressure to take remedial action. They also involved significant regulatory settlements, which typically can create significant financial and reputational damage to the company, as well as claw backs of compensation and the firing of executives.

Boeing exemplifies the concept that harm to the public can be laid at the feet of the board in the form of a *Caremark* claim alleging breach of fiduciary duty through failure to implement or oversee systems of control. Following two high profile plane crashes involving the Boeing Max 737, the defendants settled the derivative litigation for a cash payment to the company of $237.5 million, which was fully funded by insurance.

Many commentators have suggested that *Boeing* has ushered in a new era of enhanced scrutiny for boards by designating product safety risks as "mission critical" for companies in regulated industries. Post-*Boeing*, a "mission critical" designation means that boards will be critiqued not only for what they knew but also for what they should have known, and not just for doing nothing, but also for not doing enough. *Boeing* also illustrates another trend in derivative litigation – plaintiff's use of 220 demands to build their cases. Delaware General Corporate Law Section 220, and other similar state laws, provides shareholders the right to access company books and records. The Delaware courts have recently taken an expansive view of the types of documents that plaintiffs are entitled to, essentially allowing pre-litigation discovery. In *Boeing*, plaintiffs were given access to over 44,000 internal documents containing 630,000 pages about Boeing's oversight of airplane safety.

Into the Forefront

Moving into 2022, there were three derivative settlements with monetary components in excess of $100 million, *Altria*, *Cardinal Health,* and *First Energy*. These cases demonstrated continued shareholder focus on using derivative litigation as a vehicle to rectify alleged harm to the company that is, in turn, a result of alleged harm to the public. *First Energy*, which settled for $180 million, included many of the hallmarks that have accompanied other settlements with large monetary components, including a $230 million fine, a deferred prosecution agreement, criminal proceedings and litigation filed across multiple jurisdictions. While it was

not the largest derivative settlement we have seen, it cannot go unnoticed that that a bribery scheme of elected officials placed it in the top 10. Notably, *First Energy* was funded by insurance, as was *Cardinal Health*, with the amount of available Side-A insurance being specifically highlighted in the court approval process.

The cases noted above as well as many others, clearly demonstrate that derivative actions can stand on their own merits and are no longer limited to tag-along status

Looking at the subset of derivative settlements from the first half 2023, the largest arose from merger and acquisition transactions involving controlling shareholders who were alleged to have manipulated multiple roles in conflict with the interests of shareholders. These cases demonstrate that courts and shareholders will hold boards responsible in the context of executives who allegedly attempt to usurp benefits for themselves. Notably, two of the three cases in this category (*Charter* and *Madison Square Garden*) settled for less than $100 million. While still substantial, it could be suggested that settlements of this variety are less likely to reach into the stratosphere. Also notable, and perhaps a downward driver on these settlements is the fact that two derivative cases arising out of controlling shareholder transactions were tried in Delaware – *BGC Partners* in 2021 and *Oracle* in 2022 – and both resulted in defense verdicts.

The cases noted above as well as many others, clearly demonstrate that derivative actions can stand on their own merits and are no longer limited to

tag-along status, content to be dealt with after settlement of the securities class action. An additional complicating factor with derivative actions is that unlike with a securities class action, which is typically consolidated into one case, derivative actions can be filed in multiple courts, and jurisdiction can be found in both state and federal courts. It is also not uncommon for multiple plaintiff firms to be involved. For example, in *Wells Fargo*, two dozen plaintiff firms received a portion of the plaintiffs' fee award. These comments should not be taken to imply that "garden variety" tag-along derivative actions are in decline. They continue to be filed routinely. Given the factors discussed above and the recent economic downturn, which generally drives claim activity, directors and officers increasingly find themselves having to make difficult decisions involving allocation of limited resources and the potential for non-indemnifiable exposure.

Looking Ahead

This brings us to the present moment. *Tesla* opened the second half of 2023 with a derivative settlement valued at $735,266,505. Two settlements of more than $100 million and two just below that threshold occurred in the first half of 2023. These figures suggest an almost certain upward trend of derivative settlements in contrast with the years 2020, 2021 and 2022, which each saw three or four mega derivative settlements total per year. Considering this statistic alone, it seems likely that 2023 is on track to be a notable year for large derivative settlements. Indeed, there are several high-profile derivative cases in the pipeline including the *Walmart, Inc.* opioid derivative litigation and the *Fox Corporation* derivative litigation

related to the Dominion and Smartmatic defamation cases.

Conclusion

In conclusion, several things can be true at once. Yes, recently there have been more derivative settlements with very large monetary components than there were five years ago, and yes, they are still relatively rare when contrasted to very large securities class action settlements. Unfortunately, even cases with little merit settle for myriad reasons, necessitating adequate Side-A coverage for all boards, no matter how well-functioning. As the potential exposure of directors and officers to derivative litigation has increased in recent years, a decision to be without adequate Side-A coverage could be disastrous, both financially and personally.

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About the Author

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Erin is Vice President, Head of Financial Lines Claims for Vantage Insurance. Erin joined Vantage in July 2022 to lead the management liability and financial institutions claims division. She brings 20+ years of experience in the insurance industry to Vantage, specializing in the management of complex financial and professional liability claims and claims professionals, policy and endorsement drafting as well as underwriting consulting. Erin is a graduate of the University of Connecticut and the Quinnipiac University School of Law. She is admitted to the Connecticut Bar.

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