

## 9 Reasons to Expect More Class Action Lawsuits and Higher D&O Prices in 2019



A convergence of emerging litigation trends has driven securities class actions to an all-time high. That means greater D&O exposure for every executive.

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Rates are likely to rise for many lines of insurance in 2019, and management liability is no different. In the year ahead, the management liability market will be “stable, but firming,” said Keith Riccio, Vice President, Management Liability and Specialty, Nationwide.

On average, companies can expect to see 10 to 20 percent increases in D&O pricing at renewal, which Riccio said is “significant, but warranted” given prolonged soft market conditions amid growing loss frequency and severity.

“If you compare the D&O market five years ago to today, it’s safe to say anywhere from 20 to 30 percent of premium has been taken out of the market,” Riccio said. D&O losses are reaching record levels thanks largely to the growing number of recent securities class actions.

“Securities class action frequency is at an all-time high for the past three years,” Riccio said. “In 2018, the total was up 200 percent from the 10-year annual average between 1997 and 2017, according to Cornerstone Research’s latest report on securities class action filings.”

That increase is being driven by these nine factors — some of which companies and their insurers have never had to contend with before:

### 1. Stock Market Volatility Drives Shareholder Litigation

Dramatic fluctuations in stock value tend to give rise to securities class actions by dissatisfied shareholders.





Keith Riccio,  
Vice President,  
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In 2018, Wall Street experienced more highs and lows than in any prior year since the recession of 2008. Compounding the issue is that more law firms are capitalizing on the volatility by making securities litigation a core part of their business.

According to Cornerstone's "Securities Class Action Filings, 2018 Year in Review," a high number of IPOs in 2017 and 2018 have also contributed to more frequent securities filings. With 134 IPOs, 2018 was above the 2001-2011 average of 99 IPOs per year but remained well below the 1997-2000 average of 403 IPOs per year.

"Stocks offered in an initial public offering are more vulnerable to market volatility," Riccio said. Going public during a downturn can immediately negatively affect stock value, disappoint investor expectations, and draw a lawsuit.

## **2. M&A Activity Means Merger-Related Lawsuits**

Though the total number of mergers and acquisitions dropped slightly in 2018 over 2017, the trend of consolidation is still strong. Deal value also increased. Global M&A deals made through the first three quarters of 2018 were worth nearly \$3.3 trillion, a 39 percent increase over 2017.

"Any time you have a merger or acquisition, there's a chance you'll see what's called a 'bump-up' or merger-related lawsuit," Riccio said. "That inflates the total class action number."

According to Bloomberg Law, 204 new securities class actions were filed in first half of 2018, and more than 45 percent of them were merger-related.

## **3. Event-Driven Litigation Presents New Liability Exposure**

Companies are increasingly facing liability action over catastrophic events. After the destructive wildfires that wrought havoc across California in 2017, for example, utility companies are facing allegations that their equipment played a role in sparking the flames.

"Energy companies have seen D&O claims arising out of their potential involvement in starting these fires," Riccio said. "Events like this traditionally would not be perceived as a D&O exposure. It's a new market dynamic leading to an increase in securities class actions, which is leading to increased losses in a market that hasn't priced for it."

## **4. Boards of Directors Face Accountability for Data Breaches**

Securities class actions related to data breaches are growing more common and costly. "We're starting to

see D&O claims arise from data breaches and failure to disclose appropriately to the market information regarding any breach an organization suffered,” Riccio said.

Plaintiffs’ attorneys are quick to file suit on behalf of shareholders based on significant drops in stock value following the disclosure of a breach, and on allegations of misrepresentation in SEC filings regarding the strength of their cyber security prior to the breach.

In a recent high-profile case, Yahoo paid \$80 million in September of 2018 to settle a securities class action alleging that the company repeatedly misled investors after four separate data breaches that affected as many as 5 billion accounts. Over the course of 2018, at least nine such actions have been filed against public companies related to a data breach.

## **5. Allegations of Sexual Harassment Imply Board-Level Mismanagement**

Class actions may arise from allegations of sexual harassment against senior executives of a company but will target the entire board of directors over how they handle the situation. Lack of adequate disclosure about the incident or an insufficient response can hurt the company’s stock value and ultimately be fodder for a securities class action.

Plaintiffs can also allege that the company misled investors by not disclosing patterns of misconduct committed by senior executives and failed to acknowledge the negative impact of misconduct on the company’s reputation, legal liability exposure, and overall ability to operate. If company assets were used to make confidential settlements with accusers, then allegations can also include breach of fiduciary duty.



## **6. Social Media Amplifies Effects of Any Negative News**

Social media adds fuel to the flame when it comes to many emerging sources of D&O exposure. The #MeToo movement, for example, has made accusations of sexual harassment front page news. Anger over incidents like data breaches or supposed liability for natural disasters can build and spread faster.

When negative news travels farther and lingers longer, it prolongs the impact of any negative event on a company’s stock price, sparks calls for further investigation, and may attract the attention of attorneys looking for a deep-pocketed target.

“Social media has played a role in giving rise to securities class actions that 10 years ago would not have

been filed, simply because it creates an extended period of negative press that companies have a harder time coming out of unscathed,” Riccio said.

## **7. The Cyan Decision May Mean More Suits and More Defense Costs**

In the case of *Cyan Inc. v. Beaver County Employees Retirement Fund*, the Supreme Court ruled early last year that securities plaintiffs could bring class actions against companies under the Securities Act of 1933 in state courts.

“Prior to this decision if you had a securities claim in state court and federal court alleging breaches of the ‘33 Act, they would be consolidated and move forward only in one jurisdiction. The Cyan decision says that the company cannot remove the state court lawsuit to federal court, even if there’s a parallel or identical federal court action. So that permits the lawsuits in state court and in federal court, with the same sets of allegations and facts, to go on side by side,” Riccio said.

“That’s causing more defense costs to be incurred on behalf of the company that’s being sued, and that’s causing more liability to the D&O marketplace because those defense costs may be picked up by a D&O insurance policy.”

## **8. Cryptocurrency Is Prone to Corruption, Volatility, and Litigation**

Because it’s unregulated and its value swings so wildly, companies investing in cryptocurrencies are very vulnerable to securities litigation.

“The cryptocurrency marketplace has been extremely volatile, which has led to a lot of D&O litigation in that space,” Riccio said. “Any time you have a new unregulated investment vehicle, it’s just ripe for manipulation and corruption, and for people to get taken advantage of.”

Most cryptocurrency purveyors that go public with initial coin offerings — or ICOs — have been hit with a securities class action. Through the first half of 2018, at least 12 ICO-related actions were filed.

## **9. Mega Verdicts and Settlements Hit D&O Policies**

Rising liability verdicts and settlements reaching into the multimillion- and even billion-dollar range also enhance D&O exposure.

“Any asset is fair game when you have a mega liability settlement, and that includes D&O insurance, whether the allegation is related to mismanagement or not. Plaintiffs’ attorneys will look for dollars wherever they can,” Riccio said.

## The Right Partner Helps Withstand Volatility

During this time of historic volatility and rapidly emerging exposure, companies absolutely need stability in their D&O carrier.

“We’ve been in the D&O market for more than 10 years and are committed to the space; we’re A+ rated, and we’re stable,” Riccio said. “Even with rising securities class action frequency and increased loss costs, we strive for a price point that is fair to both sides.”

Companies can trust in that statement because, as a mutual company, Nationwide’s fiduciary duty is to its insured members, rather than shareholders. “Our obligation is to our members, so we work hard to truly partner with them,” Riccio said.

That mission includes providing a suite of both primary and excess products for companies of every size in any sector, so a solution exists for every member. A partnership philosophy also extends to the claims approach.

“We handle all claims in-house, and we have a tremendous expertise on that side of the house. Our claims professionals work closely with underwriters in order to adjudicate as quickly as possible. We’re always looking out for members’ best interests,” Riccio said.

As professional liability risk becomes more prominent and more unpredictable, carrier stability and commitment will be critical characteristics as the market adapts.

*To learn more about Nationwide’s Commercial Liability risk management products and services, visit <https://mls.nationwideexcessandsurplus.com/fs/products/directors-and-officers-liability/commercial-d&o/> or contact Keith Riccio, vice president, at 1-212-329-6923 or [keith.riccio@nationwide.com](mailto:keith.riccio@nationwide.com).*

*Speak with your agent or broker about specific policy details and coverages. Consult your policy’s terms and conditions for specific coverage information.*



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