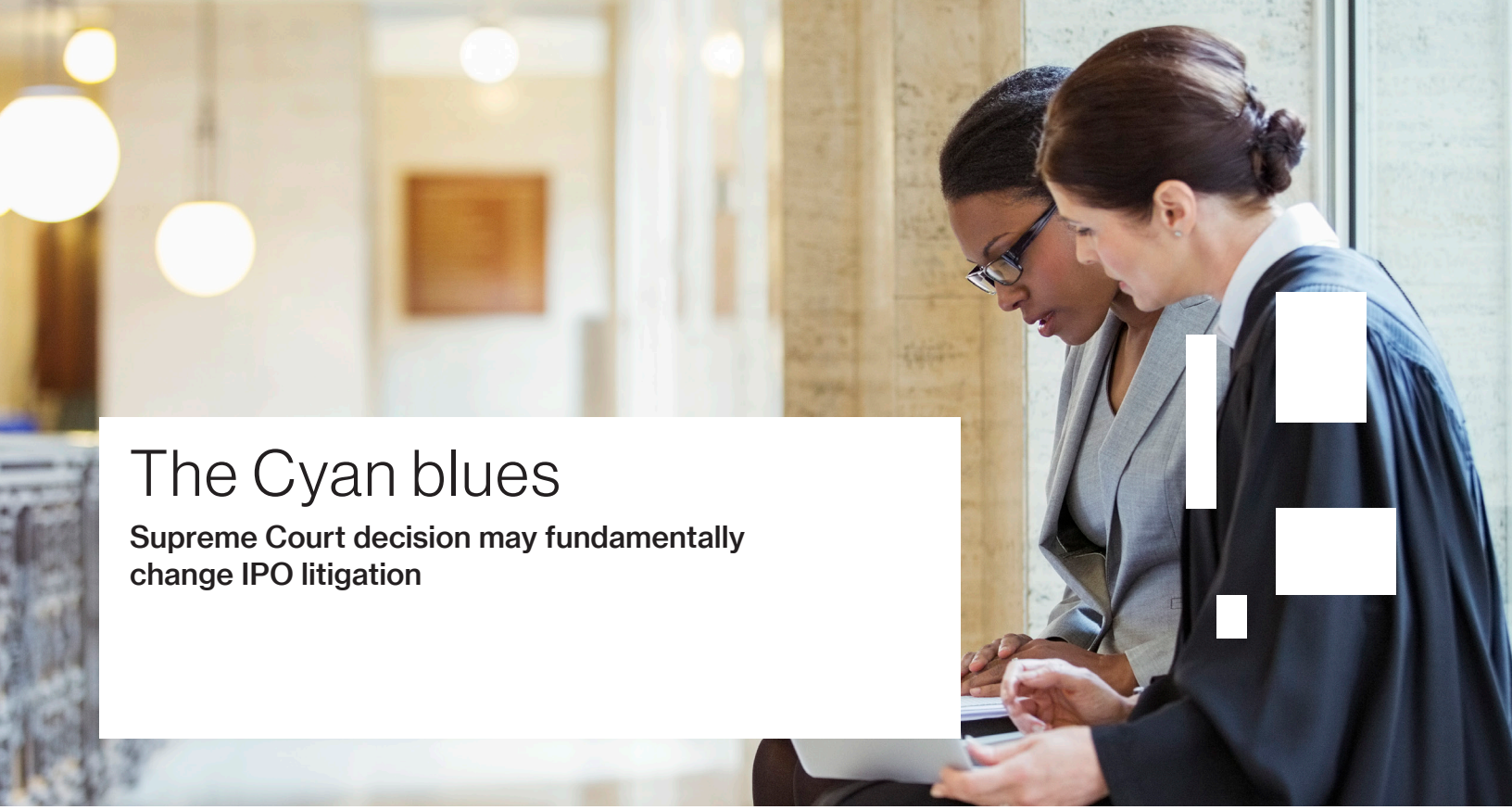

The Cyan blues

Supreme Court decision may fundamentally change IPO litigation

Executive summary

The U.S. Supreme Court's recent decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund* has spurred significant discussion around the future of initial public offering (IPO) litigation. Faced with the prospect of having to defend state court filings nationwide, along with the continued prospect of concurrent federal litigation, companies contemplating an IPO face more risk and uncertainty. With D&O insurer appetites for IPO risks already tightening, what will this mean for D&O insurance buyers? Will quality coverage continue to be available? If so, at what price?

Friendly state courts

From 2010 through 2016, plaintiffs found that they could successfully file Section 11 based securities claims in state court. Those filings increased an incredible 362% in the years 2014 - 2016. Most were filed in California state courts, which permitted these actions to proceed, and where many recent IPOs haven taken place. Dismissals proved difficult, given the plaintiff-friendly jurisdiction and lower willingness of state courts to dismiss cases in general. This decrease in dismissals, coupled with Section 11's already high bar of strict liability for issuers, led to much higher settlements than comparable federal filings; the average state court settlement equating to $9.7M. Technology, life science and biotechnology companies were disproportionately impacted due to their prevalence of location in northern California, and their proclivity to raise capital in the public markets.

Five "post-Cyan" tips

For any recent IPOs and companies preparing for an offering.

1. Evaluate **predictive analytics** (not just peer benchmarking) to test assumptions about risk frequency and severity.
2. Get **defense counsel pre-approved** by your D&O insurer(s). National firms may be better suited to coordinate a multi-state defense and resolve complex settlements with locally-respected talent.
3. Beware of potential gaps in coverage for **pre-tender claims, activist demands and legacy acts/claims**.
4. Get quotes for, and consider **buying more, D&O insurance.** Defense costs erode D&O limits.
5. Use a broker that knows how to navigate **global insurance markets** to maximize your opportunities and drive competition for your benefit.

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While Cyan was pending, state Section 11 lawsuits fell dramatically as the plaintiffs' bar was unwilling to invest in cases at risk of a pro-defendant decision. Unfortunately for issuers, D&Os and their insurers, the Supreme Court unanimously held that the Securities Litigation Uniform Standards Act of 1988 ("SLUSA"):

- Did **not** strip state courts of jurisdiction over class actions brought under the 1933 Act, and
- Did **not** permit defendants to remove class actions alleging only 1933 Act claims from state to federal court

Practically speaking, plaintiffs now have the Supreme Court's blessing to bring an offering-based securities class action in state court, void of any SLUSA controls. This brings much uncertainty about the possible resurgence of "strike suit" filings, discovery commencing before motion to dismiss rulings, and the impact on defense costs when state and federal claims do not get consolidated and concurrent class actions in multiple states progress. What is clear is that this new litigation paradigm will make cases more complex and likely more costly to litigate.

IPO D&O insurance market

How will the D&O insurance market respond to this new reality? Naturally, the likelihood of increased costs will certainly impact the D&O insurance market for those companies. IPO-exposed D&O coverage has always been harder to place than coverage for most longer-tenured public companies. Compounding this problem, the IPO market firmed in 2017 as some carriers lost their appetite for IPO-related exposure. This comes as near record-high securities litigation overall (standard securities class actions, IPO claims, M&A claims) has put increased pressure on the D&O insurance marketplace in general.

What to expect

Awareness that all the following situations are possible will help companies prepare.

- **The good.** We expect creative solutions from some markets writing primary D&O for IPO's, including higher retentions only for state-IPO litigation.

  Caution: Given that concurrent federal & state litigation is one possible result of Cyan, care must be taken to review the proposed language regarding differing retentions.
- **The bad.** We may see higher retentions overall and some sub-limited coverage(s). There may be limitations in the selection of defense counsel, which may be especially important given the prospect of parallel federal & state litigation.
- **The ugly.** There may be significant premium increases from markets taking a less "creative" and thus more punitive approach to the increased risk.

Recommendation

- Engage early with current and prospective insurers
- Pursue a well thought out level of insurance using both analytics and peer benchmarking
- Mind the fine print on any proposed wording changes
- Consider all options while weighing the pros and cons of continuing with incumbent insurers vs. engaging with new D&O insurance partners

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