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Tort Trends and Implications for Specialty Lines

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2012 Sources of Change in Tort Exposure to Specialty Insurers

Case law – State and Federal

New or Expanded Legislation – State and Federal

Administrative Agency Enforcement Actions

Administrative Agency Rule Making

Insurance Coverage Construction

Increased Incentives Promoting Litigation

Convergence Events Affecting large Populations of Plaintiffs or Defendants

Case law – State and Federal

Cases Expanding Professional's Duties to Third Parties

Exceptions to the Privity of Contract requirement for:

- Design Professionals
- Lawyers

Wal-Mart Gender Discrimination Claims – Reality Check in the Age of Collective Actions

Misconceived remedy - Respondents' backpay claims were improperly certified under Rule 23(b)(2). Backpay claims were not "incidental" to the declaratory relief.

No requisite commonality – "would have to show a common factor explaining millions of employment related decisions".

". . . testimony was worlds away from 'significant proof' that Wal-Mart operated under a general policy of discrimination."

Good news for corporate America and insurers – not just with respect to employment claims. Other similar claims have lost luster. Follow-on splinter Wal-Mart actions in California and Texas ongoing, but may have little success.

Securities Liability - The Impact of the forthcoming *Amgen decision*

In June 11, 2012 the U.S. Supreme Court agreed to review in its upcoming term whether securities plaintiffs must establish in their class certification petition that the alleged misrepresentation on which they rely was material. Currently the Ninth Circuit does not require proof that the misrepresentation was material in order to support the fraud-on-the market theory, whereas the Second and Fifth Circuits require proof of materiality.

Defendants hope the Court will dampen the power that the threat of class certification has on forcing non-meritorious settlements.

Implications: This decision will have a significant impact on the frequency of plaintiffs filing, and insurers settling securities class action claims. Could further discourage filings.

Excess Insurance - Exhaustion of Limits issues:

Forrest Labs, *Goodyear, Intel, Qualcomm*
Recent cases involving D&O towers of insurance. Cases hold that where insured reaches a settlement with one insurer that does not fully exhaust the layer, coverage in the next layer is not yet implicated. This is contrary to how most D&O claims are handled where the same coverage issue affects all tower participants.

Potential for applying trend to other lines of insurance.

Implications for actuarial reserving: Insureds will be less willing to settle with individual tower participants. Global settlements will take longer - increased latency in loss reserving and payments.

Emerging Issue – Imposition of a Notice Prejudice Rule in Construing Late notice under Claims-Made Coverage

Claims –made trigger is intended to prevent latency; requires notice to the insurer “as soon as practicable” and during policy period (or within 30 days thereafter).

Implications for actuarial reserving: imposing a notice prejudice rule would produce “occurrence” type results.

Consider Maryland, Wisconsin, New York and variations on the trend (Texas, California). Carriers reopened and paid closed claims last year in Maryland after the *Sherwood Brands* decision.

Particular implications for carriers continuing to extend existing policy periods and not re-underwriting at renewal.

New or Expanded Legislation – State and Federal

Social Media, and Employers' Background Checks

Employers' Background Checks:

Perils of Employers screening unfiltered social media - inadvertent disclosures regarding protected classifications – age, race, national origin, disabilities, martial status, genetic information, sexual orientation, religion, etc.

In 2012 Maryland and Illinois enacted statutory prohibitions against forced employee or job applicant disclosure. Other states have proposed similar statutes: California, New York, New Jersey and Washington

Proposed Federal Statute - Rep. Eliot Engle and Senator Jan Schakowsky have sponsored the Social Networking Online Protection Act ("SNOP"); imposes a civil penalty of up to $10,000 per violation; prohibits current and potential employers from requiring the username or passwords to employee or applicants' private online accounts. Can't use to discipline, discriminate against, for deny employment.

Employers' Restrictions on Use of Credit Reports

States continuing to severely limit employers' use of credit history or credit-related information. Can't use for hiring, promotions, determining compensation, or other terms or conditions related to employment. Some states recognize exceptions for certain types of jobs – for example managerial, accountants, or even someone who would have an expense account. Violations may result in modest fines and do not generally give rise to civil actions. No successful passage of a comprehensive Federal law yet.

New States: Connecticut, Maryland. Other states: Illinois, Oregon, Washington, and Hawaii, plus several cities. States with pending legislation: California, Florida, Georgia, Indiana, Kentucky, Michigan, Missouri, Montana, Nebraska, New Jersey, New Mexico, New York, Ohio, Pennsylvania, Texas, and Vermont.

The JOBS Act ("Jumpstart Our Business Startups Act")

Signed into law 4/5/2012. Contains a number of "on ramp" procedures designed to ease the process of going public for Emerging Growth Companies (EGCs). EGCs can submit their IPO registration statement for SEC review on a nonpublic basis, although the statement must be filed 21days before the IPO road show.

Intended to attract investors for small companies. EGCs may raise up to $1M during any 12 month period through an SEC registered "crowdfunding" portal. Private companies can avail themselves of this process but they have to make disclosures through SEC filings. Imposes security liability for crowdfunding issuers similar to Sect. 12 of the Securities Act.

Private company insurers are already incorporating policy exclusions for crowdfunding activities. We are a long way from being to assess the implications of this legislation to the insurance industry.

Administrative Agency Enforcement Actions

Enforcement Action Uptick

EEOC redirecting resources to pursue actions on behalf of claimants especially in the areas of:
Disability Discrimination, Hiring Practices, Use of Arrest and Conviction Records, Equal Pay Act Cases, Gender Discrimination,

and
Retaliation - not a new subject, but has become the highest source of EEOC filing form a frequency standpoint, and a focus issue for EEOC enforcement. Recent cases supporting claims for retaliation. See, e.g., *Thompson v. North American Stainless* -the Supreme Court held in favor of the plaintiff whose was fired after his fiancée complained of sexual harassment. The Court found Title VII provides a cause of action for third-party retaliation for persons who did not themselves engage in protect activity.

Enforcement Action Uptick

DOL has stepped up efforts to punish employers who misclassify employees as “independent contractors.”

SEC Enforcement Actions up 11% over the last two years.

Example of recent EEOC Enforcement Action:
Macy v. Holder – April 2012 EEOC Landmark decision expanding the applicability of Title VII to a transgender employee's claim of discrimination based on gender identity, change of sex and/ or transgender status.

NLRB Enforcement Actions

"Protected Concerted Action" under Section 7 of the National Labor Relations Act ("NLRA") - employees have a right to engage in protected concerted activity (i.e., when two or more employees acting together protest or complain about wages, benefits, or other terms and conditions of employment).

Applies to *all employers* (other than religious school and municipal and government workers) - *not just unionized work forces.*

Is currently excluded from employment practices forms under the blanket NLRA exclusion.

Insurers and employers largely have not focused on this risk. But it has received the attention of numerous courts and the NLRB recently. Very significant emerging issue for employers. Insurers might want to consider insuring this risk.

Recent Protected Concerted Action Developments

NLRB has ruled employment-at-will acknowledgments in an employee handbook may violate employees' Section 7 rights.

NLRB has reviewed the common social media policy as contained in that of Costco Wholesale Corporation – how far can employers go in enforcing a non-disparagement rule.

D.R Horton decision – Controversial NLRB ruling that holds Section 7 trumps Mandatory Arbitration Agreements including limitations on employees rights to participate in class action litigation.

Many NLRB rulings in areas related to employee conduct which speaks to working conditions.

Administrative Agency Rule Making

Administrative Agency Rule Making

If there is no law, the agency promulgates “rules,” “guidance,” and “compliance initiatives”.

Examples:
Rules mandating record keeping in conjunction with the Genetic Information Nondiscrimination Act

In March 2012 EEOC published rule governing the Reasonable Factors Other than Age (RFOA) defense for disparate impact age discrimination claims making it more difficult to defend such claims based on “business necessity.”

2012 Updated guidance on “Consideration of Arrest and Conviction Records in Employment Decisions under Title VII

Administrative Agency Rule Making

Another example:

Current uptick in disability cases - 2008 Congress passed the ADA Amendments Act ("ADAAA"). The EEOC, however, waited several years to implement regulations interpreting the new act, finally doing so on May 24, 2011. EEOC broadly expanded the definition of major life activities for purposes of determining what constitutes a disability. Defendants now get one bite at the apple, instead of two.

Insurance Coverage Construction

EPLI – Increased Exposure from Fair Labor Standards Act (FLSA)

Wage and Hour claims represent the bulk of most of the expensive employment related litigation. The frequency of claims is skyrocketing. FLSA Exclusion constantly being tested.

Do any of the allegations qualify as an enumerated "wrongful employment act"?

"Employment related misrepresentation"

"Failure to create or enforce adequate workplace or employment policies or procedures"

Are violations of State counterpart laws "similar" to the FLSA?

Constellation of tangent allegations which may not be "similar" enough. Examples: failure to provide claimants itemized wage statements; statutes mandating payment of unpaid wages at time of termination; industrial welfare acts mandating meal and rest breaks.

EPLI – Increased Exposure from Fair Labor Standards Act (FLSA)

Did we remove "retaliation" from the FLSA Exclusion? – is carrier involved in the entire defense?

Cost-benefit analysis in assessing whether to file coverage actions.

Insureds are succeeding in "Bad Faith" claims.

Difficulty in allocating expenses after-the-fact for uncovered exposure. – burden on the carrier; legal rules governing allocation.

Employment Related Spillover into GL

Epidemic of policyholders challenging GL policy language intended to limit employment related exposure to the EPLI endorsement.

Are the employer's actions "employment related"?

Proliferation of cyber and privacy related issues in the workplace. Facts often involve invasions of privacy and defamation, potentially implicating Personal Injury coverage.

"Property Damage" under the GL for loss of money in-specie.

Bad Faith predicated on defending under the wrong coverage.

Convergence Events Affecting Large Populations of Plaintiffs or Defendants.

Sometimes Affect Diverse Professionals Simultaneously such as Attorneys, D&Os, Accountants, Appraisers, Real Estate Agents, Loan Brokers, Title Companies, etc.

EPLI - The Economy and Jobs

Good News: The rate of increase in Bias Claims is decreasing. Probably reflects the fear of loss of jobs in a horrendous job market.

Bad News: Administrative Agency Enforcement Actions are on the Increase.

Takeaways: Expect fuller investigations and more willingness for agencies to do more than just issue a “right to sue” letter. Early report of claim to carriers is essential. The legal representation at the Administrative Agency stage is more important than ever.

Public D&O – Frequency of Securities Litigation

Conflicting views about whether the frequency of securities class action claims have declined on an absolute basis. NERA Economic Consulting 2012 Mid Year Review reflects they are at, or above historic levels. Average number 1996-2011 is 217 per year.

Frequency certainly has increased on a relative basis, given the 45% reduction in publicly traded companies since 1996.

Growing acknowledgment that traditional strike suits are more difficult to win in the wake of important positive U.S. Supreme Court decisions. *Tellabs -2007* (plaintiffs have to show "cogent and compelling intent to engage in wrongdoing"); *Morrison- 2010* (significantly restricting the exterritorial application of US Securities laws) .

Rise of Merger and Acquisition Securities Litigation

Today, 96% of companies announcing an acquisition are sued,

Number of M&A securities lawsuits:

Year	Number
2001	4
2009	191
2010	341

Merger Objection suit filings for the first half of 2012 are slightly off the pace of 2010 and 2011.

Suits filed within 4 weeks of announced merger; 90% settled within 100 days thereafter.

Subject to fluctuating market cycles on M&A activity, no reason to suggest merger objection suits will not continue. Plaintiffs lawyers recovering their fees atop the settlement.

Settlements and Dispositon- All Securities Litigation

Some interesting NERA statistics:

Looking back on cases filed between 2003 and 2006, it appears that the dismissal rate is 43% or more.

The majority of cases (58%) settle before a motion for class certification has been filed. Of the cases where a class certification motion is filed, 46% settle before the motion is resolved.

Median settlement value if class certification granted	$16.5M
Median settlement value, all cases	$9.1M

Pace of settlements so far this year is down.

Average value this year (including some settlements over $1B) is up

Average settlement years 2005-2011:	$46M
Average settlement first half 2012:	$71M

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D&O/BPL - Libor Scandal-Related Litigation

London Interbank Offered Rate (Libor) - The baseline interest rate used in the valuation of more than $200 trillion in derivative financial products. The total value of all securities and loans relying on Libor totals $800 trillion. Worldwide GDP is $69.65 trillion.

Has resulted in a significant on interest rate payments for homeowners, companies and investors over the first four months of this year.

U.S. banks participating on Libor panels - Bank of America, the U.S. dollar panel; Citigroup participates in several panels (U.S. dollar, British pound and Euro). JP Morgan Chase participates in nine of the ten Libor panels. Other participating banks from several other countries, including the U.K. France, Germany, Japan, and Switzerland.

D&O/BPL - Libor Scandal-Related Litigation

In the end, while the Libor scandal related follow-on litigation could be massive, it may not prove to be a significant event for the D&O industry.

Many suits alleging antitrust violations name only corporate entity defendants. (No entity coverage under D&O policies for antitrust allegations; Company investigative costs also likely not covered.) Involved banks may have large insurance retentions or limited D&O coverage.

Illinois Brick doctrine. This doctrine basically says that indirect purchasers of goods and services cannot assert antitrust claims.

Banks' Civil Litigation Exposure – Could be of the same magnitude as their regulatory fines and penalties – ranging in the hundreds of millions of dollars each. At least one recent Barclays federal securities shareholder claim has been filed.

D&O - Bank Closures

Bank failure closure rate falling:

Failures since January 1, 2008:	454
Failures 1/1/20011-8/31/2011:	74
Failures 1/1/20012-8/31/2012:	40
Failures for month of August 2012:	1

Banks rated by FDIC as “Problem Institutions” down significantly, although more than 10% of depositories institutions still fall in this category.

There may be much further to go before the current banking crisis is fully behind us.

FDIC Receiver Lawsuits Against Banks' former D&Os

FDIC has indicated it has approved suits involving 73 failed institutions which involve some 617 individuals. But pace of filings is falling precipitously.

Total FDIC sponsored lawsuits to date:	32
Total FDIC suits filed in 2012:	14
Total FDIC lawsuits filed since 7/15/2012:	0
Statute of limitations for bringing lawsuits:	3 years
Bank closures within the three years before the current filing lull:	over 50

Summary: all in, there might be as many as 86 FDIC lawsuits against D&Os of failed Institutions in the current bank failure wave. The rate may pick-up, but we are beginning to believe we are not going to see as much litigation as had been anticipated.

Playout of Long-Running Subprime Lending Litigation

Investor suits premised on failure to disclose toxic assets such as Collateralized Debt Obligations.

The first subprime and credit crisis related securities suit was filed in February 2007. 240 credit crisis securities class action lawsuits were ultimately filed. Over the past five years these have slowly been making their way through the system. Many have not survived a motion to dismiss. Aggregate of all settlements is now about $7.93 Billion. Taking out the five settlements each costing over $500M, the average settlement is about $73M.

Pace of settlements is declining.

Settlements from 1/1/2011 to 8/31/2011:	16
Settlements from 1/1/2012 to 8/31/2012:	11

Not at the end yet. Expenses are enormous. B of A defense costs, for example, exceeded $150M.

Increased Incentives Promoting Litigation

Lots of Hype about Whistleblower Bounty provision in the Dodd-Frank Act

Program established in August 2011. Provides for a bounty of between 10% and 30% of any recovery from an SEC enforcement action award of over $1M. SEC's August 21, 2012 press release reflects the SEC has made its first award: $50,000.

Supposedly the agency has been receiving "high quality" tips at the rate of about eight per day.

Companies are afraid this program will lead to bypassing the internal complaint procedures of companies. Also fear of follow-on civil litigation. We do not underestimate the potential for a significant uptick in provable Securities claims. But it is too early to tell whether these fears are justified.

Other Bounty Hunter Provisions

Government is aggressively pursuing Medicare and Medicaid fraud and abuse through auditing healthcare provider billings. Government hiring auditors who are compensated on a contingency fee basis tied to amount of savings.

False Claims Act Allegations & Quit Tam Actions

Implications for more insurer defense costs, Billing E&O, and Forensic Audit expenses.

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