



# **Casualty Actuarial Society 2009 Casualty Loss Reserve Seminar**

**Kevin M. LaCroix, Esq.  
Chicago Marriott Downtown  
Chicago, Illinois  
September 14, 2009**





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## Kevin M. LaCroix

- Partner, OakBridge Insurance Services, LLC, Beachwood Ohio
  - OakBridge is an insurance intermediary specializing in management liability insurance placements for public and private companies, as well as private equity and venture capital funds and other alternative investment vehicles.
- 1995 to 2005: President, Genesis Professional Liability Managers, Inc. (a Berkshire Hathaway company)
- Previously, Partner, Ross, Dixon & Bell, Washington, D.C.
- Professional Liability Underwriting Society (PLUS): President (2004), Board Member (1999-2005), Foundation Board Member (current)
- Co-Chair, PLUS D&O Symposium, 2007 through 2009
- Faculty, 2009 Stanford Law School Directors' College
- Author, *The D&O Diary* (Internet weblog)



## Subprime-Related Shareholder Litigation

### Subprime-Related Securities Class Actions

199 Total, including 101 in 2008

2007: 40 SCAs

2008: 101 SCAs

2009: 58 SCAs

21 Auction Rate Securities Investor Actions

Shareholders' Derivative Lawsuits: 28

ERISA Lawsuits: 22

Source: The D&O Diary , as of August 31, 2009

## The Evolving Litigation Wave: Defendants

- 2007:
  - Mortgage loan originators, home builders
  - Investment Banks
- 2008:
  - Bond insurers, mortgage guarantee insurers
  - Student lenders, commercial lenders, commercial construction
  - Broker-Dealers
  - Securities Issuers (asset backed securities; preferred or subordinated securities)
  - Foreign domiciled financial institutions
- 2009:
  - *More* Securities Issuers
  - Toxic Assets on the Balance Sheet

## The Evolving Wave: Gatekeeper Claims

- Securities Underwriters
- Rating Agencies
  - Cheyne Financial: First Amendment Defense Rejected
- Accounting Firms
  - New Century Financial Corp. Trustee's Claims Against KPMG
  - Securities Class Action Litigation: New Century, Countrywide

## **“Subprime?": No, Credit Crisis Related**

### Student Lending:

SLM Corporation (Sallie Mae)

First Marblehead Corp.

### Corporate Debt:

iStar Financial

### Construction Project Financing:

Perini Corp.

### Credit Cards:

American Express



## Subprime-Related Securities Lawsuit Settlements (as of 9/08/09)

Company	Date	Amount
Merrill Lynch	1/16/09	\$475 mm
Merrill Lynch Bond Action	8/21/09	\$150 mm
American Home Mortgage	7/7/09	\$37.25 mm
RAIT Financial	5/26/09	\$32 mm
Accredited Home Lenders	7/15/09	\$22 mm
Luminant Mortgage	12/08/09	\$ 8 mm
WSB Financial	10/14/08	\$4.65 mm

Note: Merrill Lynch ERISA Suit Settled for \$75 mm

Source: The D&O Diary





## Motions to Dismiss in Subprime-Related Securities Lawsuits (as of 9/08/09)

- Dismissal Motions Granted:
  - 19 (seven with prejudice)
  - Eighth Circuit Affirmed Dismissal of NovaStar Subprime Securities Suit
- Dismissal Motions Denied:
  - 11 (in whole or in part)
- Significant Dismissal Motion Denials: Countrywide, New Century
- Significant Case to Consider: BankAtlantic Bancorp.
  - Original motion granted, with leave to amend
  - Renewed motion (on amended complaint) denied
- NovaStar: Securities Suit dismissed, but not ERISA suit

## Defendants' Dismissal Motion Theories

- Atmospherics
  - Global Financial Calamity Hurt Everyone
  - “Fraud by Hindsight”
  - Financial Woes Do Not Equal Fraud
- Legal Arguments
  - *Tellabs* (Scienter)
  - *Dura Pharmaceuticals* (Loss Causation)
  - *Stoneridge* (Private civil liability for primary violations only)

## How Far Along Are We?

First Lawsuit of Current Wave: February 2007 (New Century Financial)

Compare to Cadwalader Litigation:

- Initial complaint filed in October 2007
- Counsel in Commercial Mortgage Securitization
- Transaction Took Place in 1997
- Motion to Dismiss Denied in May 2009

## Second Quarter SCA Filing “Lull”?

- 94 new securities class action lawsuits in the first half of 2009
  - 1Q09: 59 new SCAs
  - 2Q09: 35 new SCAs
- Annualized Rate = 188 (vs. '96-'08 average of 197.7)



## *Second Quarter Lull or Two-Month Lull?*

Month	# of SCAs
January	19
February	20
March	20
April	18
May	11
June	5



## Two-Month Lull? Don't Get Carried Away

- Over the years, filings ebb and flow
- Predications of “permanent change” have hurt industry before
- Plaintiffs’ lawyers were busy, just not with new SCAs
- “Lull” probably over as soon as 3Q09 started
  - 20 new SCAs in July 2009
  - 17 new SCAs in August 2009
- Evidence of “backlog” suggests “logjam”
  - Many 3Q09 SCAs with long past class period cutoffs
  - Many against nonfinancial companies

## Possible Future Directions? Credit Crisis Litigation

1. Additional Disclosure or Suitability Actions against Financial Sector
2. Disclosure Actions Outside the Financial Sector
3. Actions Against the Rating Agencies
4. Actions Against the Investment Banks for Securitization Errors
5. Lawsuits Involving Other Kinds of Credit Exposures: Credit Cards, Auto Loans, Commercial Mortgages, Student Loans
6. Lawsuits involving other Securities and Instruments: e.g., Credit Default Swaps, Subordinated or Preferred Securities, etc.

## Credit Crisis Litigation?: Commercial Mortgage Backed Securities (CMBS)

- Commercial Mortgage Defaults Have Already Led to SCA vs. Issuers, Others
  - General Growth Properties
  - Station Casinos
  - Perino Corporation
  - MGM Mirage
- Precedent for CMBS Litigation from Earlier Era
  - Nomura/LaSalle/Cadwalader Lawsuit
- CMBS documentation = less generic, more specific, more documentation of reps and warranties;
- Underlying Assets Troubled: WSJ estimates \$100 bb in commercial loan losses by YE 2010.

## Credit Crisis Litigation?: Trust Preferred Securities

- Hybrid Security Issued by Bank Holding Company's Separate Trust Vehicle
- Trust Issues Shares to Investing Public in Securities Offering (Form S-3)
- '33 Act Litigation Arising Out of Credit Crisis:
  - SunTrust Bank
  - Regions Financial
  - Deutsche Bank
- Variation: SCA based on investor's Trust Preferred Losses:
  - RAIT Financial

## Future Litigation?: “Dead Bank” Litigation?

- 25 Bank Failures in 2008
  - Most since 1994 (last failed bank era)
  - 8 already sued in SCAs (even though only 11 public cos.)
- 2009: Already 89 Bank Failures (as of 9/04/09)
  - More than two-thirds involved banks with assets under \$1bb
  - FDIC Quarterly Report (dated 8/27/09): 416 “Troubled” Banks as of 6/30/09
- Failed Banks = Failed Bank Litigation?



## Future Litigation?: Bankruptcy-Related Issues

- Bankruptcy Filings Up for the Year Ending 6/30/09
  - Business Filings Up 63% (from 33,822 to 55,021)
    - Source: Administrative Office of the U.S. Courts
- Coverage Issues:
  - Possible Side-A Issues?
  - Insured vs. Insured Issues:
    - Creditors Committee; Debtor-in-Possession

## Future Litigation: D&O Lawsuits Other Than SCAs?

- Advisen Mid-Year Report: SCAs as a percentage of all D&O litigation declining
- Trend began as early as 2006 (options backdating)
- SCA Class Settlement Opt-Outs Another Factor
- Many Institutional Investors Prefer Individual Rather than Class Litigation
- Significant Credit Crisis Litigation Not Class Action (esp. CDO, ARS and CDS litigation)
- Madoff Litigation, Too

## Credit Crisis Litigation: Who Will Pay for All This?

- Different Lines of Insurance Potentially Triggered
  - D & O Liability Insurance
  - Fiduciary Liability Insurance
  - Investment Management E & O
  - Bankers' Professional Liability Insurance
- Complication #1: Large Bank's Insurance Structures
- Complication #2: Bankruptcy
- Complication #3: Simultaneous Civil Litigation, Criminal Investigations, Regulator Action

## Credit Crisis Litigation: Who Will Pay for It?

- Will Losses Hit D&O or E&O?
  - Auction Rate Securities Litigation
  - Madoff-Related Litigation (particularly Feeder Fund litigation)
  - Underwriting malpractice lawsuits

## Effects on D&O Insurance Marketplace

- Tale of Two Markets: Financial vs. All Else
  - Increased Financial Underwriting
- Advisen Predicting Hard Market Late '09- Early '10
- Early Sign: Commercial Banking (esp. Community Banks)
- Meanwhile: Competitive Market for Most Accounts



# THE D&O DIARY

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

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## More About Life Sciences Companies and Securities Litigation

Posted on April 16, 2009 by **Kevin LaCroix**



In prior posts (most recently [here](#)), I discussed the fact that while litigation against the financial sector has predominated recent securities lawsuit filings, plaintiffs' attorneys also have targeted other sectors, including in particular the life sciences sector. An April 2009 memorandum by **David Kotler** of the **Dechert** law firm entitled "Dechert Survey of Securities Fraud Class

Actions Brought Against Life Sciences Companies" ([here](#)) takes a closer look at the 2008 life sciences securities lawsuits and analyzes the allegations on which the claims are based.

The memo notes that the 23 securities lawsuits filed against life sciences companies in 2008 is about the same number as the 25 life sciences securities lawsuits filed in 2007. However, the report also notes that the 2008 life sciences securities lawsuit filings represented only 10% of all securities lawsuit filings during the year, compared to 14% in 2007. The report attributes this slight drop to the fact that securities lawsuits in the financial sector "skyrocketed" in 2008.

The memo reports that, similarly to prior years, half of the life sciences companies sued in 2008 were very small, with market capitalizations below \$250 million. However, by contrast to 2007, when nearly half of the life sciences companies sued had market capitalizations greater than \$10 billion, on 2008 "only 13% of total actions were brought against the largest companies."

With respect to the allegations raised in the new lawsuits, the memo notes that in 2008, the majority of claims "pertained to accounting improprieties and/or misstated or misleading financial results and forecasts, by comparison to the 2007 filings, where industry-specific issues such as product safety, efficacy, manufacturing and distribution



PUBLISHED BY  
**Kevin M. LaCroix**

Kevin M. LaCroix is an attorney and a Partner in OakBridge Insurance Services, Beachwood, Ohio. OakBridge is an insurance intermediary focused exclusively on management liability. [MORE...](#)

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INSURANCE SERVICES

## The D & O Diary

The D & O Diary:

<http://www.dandodiary.com>

## Contact Information

**Kevin M. Lacroix**

OakBridge Insurance Services

2000 Auburn Drive

Beachwood, CO 80521

(216) 378-7810

[klacroix@oakbridge.com](mailto:klacroix@oakbridge.com)

