



# Year End Claims Journal

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Financial Services and Management Liability



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## Regulatory Oversight of Cyber Incidents Continues to Expand

There were significant strides taken by various regulatory agencies concerning the response and oversight of cyber events in 2023. These agencies have recognized that not only are cyber events becoming more prevalent and severe, they also pose a significant risk to investors, stockholders and consumers. Under the auspices of protecting the public at large, several agencies have placed the cybersecurity of the entities they oversee directly in their crosshairs.

In July, the Securities and Exchange Commission (SEC) adopted their final rule concerning cybersecurity incidents and governance. Their approach was twofold. Firstly, in the wake of a cyber event, the registrant would be obligated to determine if the event was material. In other words, it would lead to events that would have a material effect on the company, such as reputational harm, potential litigation or regulatory actions. If so, the company would be required to file a notice with the SEC no more than four days after the materiality determination was made. The SEC would be looking for disclosure of not only the nature and extent of the event but also the likely projected impact on the company.

Secondly, the SEC rule requires companies to disclose the board of directors' oversight of cyber risk for the company. They must disclose they have a process in place to monitor, assess and manage cybersecurity threats. The disclosures must be sufficient for a reasonable investor to comprehend them.

In October, the Federal Trade Commission (FTC) amended its cybersecurity rules for nonbank financial institutions (FI). The original rule, known as the Safeguards Rule, which initially inceptioned in 2003, covers entities such as mortgage brokers, car dealers and payday lenders, and was designed to provide guidelines regarding data security. Requirements such as data encryption and multifactor authentication to minimize the exposure to a breach were the goals of the FTC Safeguards Rule.

The new amendment affects any data breach of the aforementioned entities involving 500 or more individuals. The FTC requires notification as soon as possible, but in no event more than 30 days following discovery.

Regulatory **muscle** is **not** only being **flexed** at the **federal** level.

In November, the New York State Department of Financial Services (NYSDFS) advised they have also revamped their requirements concerning cybersecurity events. Their more stringent rules apply to what they term a "Class A" company, denoted by a revenue stream over \$20M in each of the last two fiscal years.

They require that the superintendent is notified of any cybersecurity event as promptly as possible, but in no event later than 72 hours after discovery. Additionally, companies must report payment of any ransom within 24 hours, and then within 30 days provide a comprehensive statement to the department explaining why the payment was necessary, any alternative means considered prior to relenting payment and steps taken to ensure that they were compliant with relevant laws.

Like the SEC rules, the NYSDFS regulations also focus on governance. They require that the Class A institutions utilize a chief information security officer to report to the board any cyber issues. They are also looking to ensure the board has significant oversight of the company's cyber risk management, inclusive of the development and implementation of a comprehensive cybersecurity program.

Companies subject to regulatory authority can no longer wait until they suffer a cyberattack to respond. It is clear that authorities are looking to ensure not only that the entities have a viable plan in place to respond but also that the management and oversight of their operations are contemplative of cybersecurity.

# Directors & Officers

## Evolving Risks for Companies and their Directors and Officers

At the close of 2023, geopolitical concerns in the current corporate climate are at the forefront of directors' and officers' minds. These concerns have translated into corporate and securities lawsuits. Claims have included allegations of failure to manage climate risk to alleged breach of duties by investing in underperforming funds that actively pursued environmental, social, and governance (ESG) strategies. Between the deteriorating relations and trade tensions of the United States and China, multiple securities class action lawsuits were filed that centered around the trade issues between the two nations.

In July 2023, a plaintiff shareholder filed a securities class action lawsuit in the Northern District of California against the data storage company Seagate Technology Holdings PLC. The company was hit with a \$300M penalty for the violation of Export Administration Regulations pertaining to the Chinese technology company Huawei Technologies Co. Ltd. (*UA Local 38 Defined Contribution Pension Plan, et al. v. Seagate Technology Holdings, et al., Case No. 3:2023cv03431*). The suit alleges that the company failed to disclose it was in violation of the United States export rules, which resulted in the penalty and loss of shareholder value. The prospect for securities litigation arising out of trade sanctions and export control-related issues is not necessarily new. However, in the current tense geopolitical environment, all of these concerns are heightened. The outcome of the 2024 elections in both the US and Taiwan will have major implications for these geopolitical issues and the potential lawsuits that follow.

The artificial intelligence (AI) phenomenon has developed at an unprecedented rate, and future AI-related litigation is surely on the horizon. A third of organizations are using it regularly in at least one business function. Litigation against AI companies has already focused on privacy risks and copyright law violations, and additional litigation could include securities claims, intellectual property claims, breach of fiduciary duty claims, misrepresentation claims, and shareholder and derivative lawsuits.

Humana, one of the nation's largest health insurance providers, is **alleged** to be using an **AI model** with a **90% error rate** to override doctors' medical judgement and **wrongfully deny** care to **elderly patients** on the company's Medicare Advantage plans.

It is alleged that the use of this AI model constitutes a fraudulent scheme. The suit seeks class action status for an unknown number of other beneficiaries nationwide who may be in similar situations *Barrows et al v. Humana, Inc., Case No. 23-cv-00654 (W.D. Ky 2023)*.

SEC Chair Gary Gensler stated that the agency will begin to crack down on AI-related corporate behaviors that are similar to the practice of "greenwashing." Greenwashing refers to company actions and statements that allegedly overstate the company's actual efforts to make their operations or products more sustainable from a climate change or environmental perspective. Gensler stated that companies should not "greenwash" nor should they "AI-wash." In this context, companies should be careful not to overstate or mislead investors as to their true AI capabilities or the extent to which the company has incorporated AI into their operations or products.

An additional concern is the margin that could arise between what companies are promising with respect to their AI-related tools and the reality of what those tools will be able to deliver, especially in the financial services industries. The potential AI-related tools that financial service companies might adopt could lead to financial instability. Although AI is a new technology, the same disclosure principles still apply. A misrepresentation about AI is no different from a liability standpoint than any other misrepresentation about a company's operations or financial condition.

# Employment Practices Liability

## Noteworthy EPL Legislation and Claims in H2

The second half of 2023 saw noteworthy legislation coming out of New York and California, as well as key decisions from the Supreme Court, the US Circuit Court of Appeals for the 11th Circuit and Georgia's District Court.

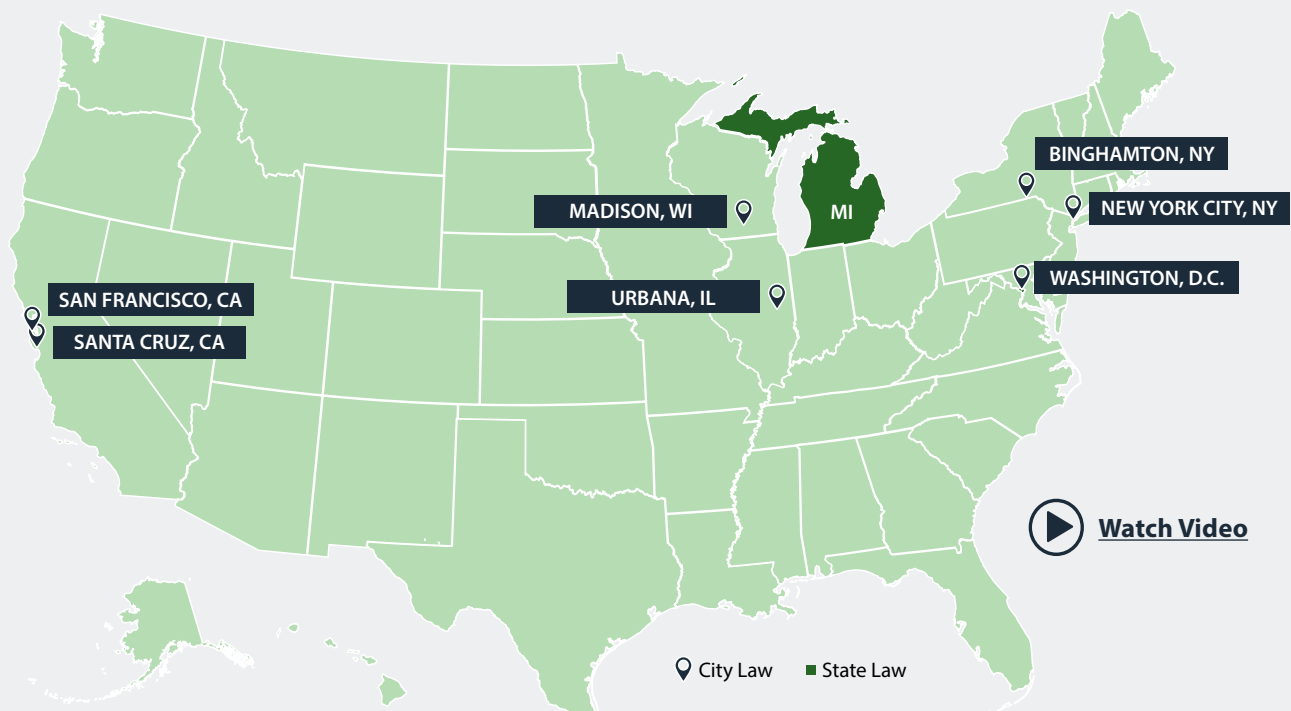
### State Actions

New York wrapped up 2023 with two significant pieces of legislation that employers should be aware of. First, New York City joins the ever-expanded list of cities with express bans on discrimination based on height and weight. On May 26, 2023, New York City Mayor Eric Adams added height and weight to New York City's list of protected categories under the New York City Human Rights Law (NYCHRL).<sup>1</sup> Effective November 23, 2023, the law prohibits discrimination on the basis of height and weight in housing, employment and public accommodations.

The law prohibits employers from discriminating against employees and applicants based on their height and weight, unless expressly permitted by federal, state, or local regulation, or where the NYC Commission on Human Rights (NYCHRL) allows such considerations because height and weight are reasonably necessary for the normal function of a particular job, or where height and weight may prevent a person from performing the essential functions of a job and no alternative accommodations are available.

The protected categories under the NYCHRL now include, age, national origin, immigration or citizenship status, race and color, sexual orientation, gender and gender identity, marital and partnership status, sexual and reproductive health decisions, pregnancy and lactation accommodations, domestic violence, stalking or sex offenses victim, religion and/or creed, active military member and veteran status, arrest or conviction record, testing positive for marijuana in a preemployment drug test, credit history, unemployment status and salary history, caregiver status and height and weight.<sup>2</sup>

## States and Cities That Have Outlawed Weight Discrimination



Additionally, New York now [prohibits](#) settlement agreements in any claim involving sexual harassment or any other form of unlawful discrimination and retaliation prohibited by law from containing any condition that requires the complainant to pay the defendant liquidated damages in the event that the plaintiff violates any nondisclosure agreement included in such settlement.<sup>3</sup> SB S4516, which amends Section 5-336 of the General Obligations Law, became effective November 17, 2023, and applies to settlements executed after that date. The law states as follows:

Notwithstanding any other law to the contrary, no release of any claim, the factual foundation for which involves unlawful discrimination, including discriminatory harassment, or retaliation, shall be enforceable, if as part of the agreement resolving such claim:

- The complainant is required to pay liquidated damages for violation of a nondisclosure clause or non-disparagement clause;
- The complainant is required to forfeit all or part of the consideration for the agreement, for violation of a nondisclosure clause or non-disparagement clause; or
- It contains or requires any affirmative statement, assertion, or disclaimer by the complainant that the complainant was not in fact subject to unlawful discrimination, including discriminatory harassment, or retaliation.

California, notoriously known for being employee-friendly, promises to continue its trend of enacting liberal legislation, beginning with its law on an employee's right to reproductive loss leave. Effective January 1, 2024, California employers with more than five employees, as well as public employers, will be required to provide eligible employees with job-protected leave of absence following a reproductive loss.<sup>4</sup> SB No. 848 makes it an unlawful employment practice for an employer to refuse to grant a request by an eligible employee to take up to five days of reproductive loss leave following a reproductive loss event. The bill also makes it an unlawful employment practice for an employer to retaliate against an individual because of the individual's exercise of the right to reproductive loss leave or the individual's giving of information or testimony as to reproductive loss.

The bill defines "reproductive loss event" as "the day or, for a multiple-day event, the final day of a failed adoption, failed surrogacy, miscarriage, stillbirth or unsuccessful assisted reproduction." The bill defines an "unsuccessful assisted reproduction" as an unsuccessful round of intrauterine insemination or an assisted reproductive technology procedure,

including an artificial insemination or an embryo transfer, and includes gamete and embryo donation. The reproductive loss event applies to a person, the person's current spouse or domestic partner, or another individual if the person would have been a parent of a child born as a result of the pregnancy. The leave must be taken within three months of the loss event within a 12-month period.

### Federal Court Decisions

The federal courts were similarly busy, with the US Supreme Court clarifying the "undue hardship" standard for Title VII religious discrimination claims, and the 11th Circuit weighing in on an employer's duty to accommodate under the Americans with Disabilities Act (ADA).

In *Groff v. Dejoy, Postmaster General*, the Supreme Court revisited the holding in *Hardison v. Trans World Airlines*, 375 F. Supp. 877 (W.D. Mo. 1974), holding that the "showing 'more than a *de minimis* cost' as that phrase is used in common parlance, does not suffice to establish 'undue hardship' under Title VII." The Court noted that the *Groff* case presented the Court with the first opportunity in nearly 50 years to explain the contours of *Hardison*.

Groff is an Evangelical Christian who believes for religious reasons that Sunday should be devoted to worship and rest, and not secular labor. He was hired by the United States Postal Service (USPS) in 2012 in a position that did not require Sunday work. In 2012, the USPS entered into an agreement with Amazon to begin facilitating Sunday deliveries, and in 2016, the USPS signed a memo of understanding with the relevant union that set out how parcel delivery would be handled. Because of the agreement, Groff was eventually required to work on Sundays. He was unwilling to do so, and so the USPS temporarily made other arrangements. He received "progressive discipline" for failing to work on Sundays and resigned in January 2019.

Groff then sued under Title VII, asserting that the USPS could have accommodated his Sunday Sabbath practice "without undue hardship on the conduct of the business." The District Court granted summary judgment to USPS. The 3rd Circuit affirmed, believing it was "bound by [the] ruling in *Hardison*, which construed it to mean that "requiring an employer 'to bear more than a *de minimis* cost' to provide a religious accommodation is an undue hardship." The US Supreme Court vacated the Court of Appeals judgment and clarified the "*de minimis*" standard in *Hardison*, holding that Title VII requires an employer that denies a religious accommodation to show that the burden of granting an accommodation would result in substantial increased costs in relation to the conduct of its particular business.

Similarly, the 11th Circuit jumped at the chance to weigh in on key elements of the ADA in its November 7, 2023, decision in *Geter v. Schneider*.<sup>5</sup> The 11th Circuit held that even though an employer could temporarily allow employees to work remotely or on a part-time basis during a pandemic does not mean that the employer must continue to offer those accommodations after the event leading to those temporary accommodations has ended, even if they can.<sup>6</sup>

Plaintiff Cierra Geter worked for Defendant Schneider National Carriers, Inc. as a full-time, night shift area planning manager (APM). Schneider is a transportation and logistics company that operates twenty-four hours a day, seven days a week. After working for Schneider for several years, Geter was diagnosed with PTSD and panic disorder following an incident that occurred prior to her employment with Schneider, which caused her to take a temporary leave from Schneider. When her leave ended, she returned to work with accommodations. Schneider allowed her to work part-time and partly from her home for several months, even though the company did not employ any other part-time APMs. Geter requested that Schneider continue to accommodate her several more times, and each time Schneider obliged. However, after three months, Geter requested another accommodation — a continuation of her part-time schedule and that she work from home two of those days. After considering various other accommodations, including reassigning her to another position and hiring a temporary employee to fill her position, Schneider denied this request and terminated Geter's employment. Schneider alleged that full-time and in-person work were essential functions of the APM position. After her termination, Geter's doctor sent a letter to Schneider asserting that Geter could not work a Monday-through-Friday schedule and could not work in a fast-paced, high-pressure environment.

Geter sued, asserting failure to accommodate, disability discrimination and retaliation in violation of the ADA, and race discrimination in violation of Title VII of the Civil Rights Act and 42 U.S.C. § 1981. Schneider moved for summary judgment on the basis that Geter was not a "qualified individual" under the ADA because full-time work and in-person work were essential functions of her job that she could not perform, and that Schneider did not treat any similarly situated employee more favorably. Schneider also argued that it should be granted summary judgment on the ADA retaliation claim because Geter failed to show a causal relationship between her request for an accommodation and her termination.

A magistrate judge issued a report and recommendation on Schneider's motion and recommended that the motion be granted. The District Court affirmed the magistrate's report and recommendation and dismissed the case, finding that Geter was not a qualified individual under the ADA.

On appeal, after considering the job description, Schneider's determination that a full-time schedule was an essential aspect of the night shift APM position, the consequences of Geter's part-time schedule, the experiences of other Schneider employees in similar positions, and the limited number of employees available to cover Geter's missed shifts, the 11th Circuit held that full-time and in-person work were essential functions of Geter's job that she could not perform. Therefore, she was not a qualified individual as required by the ADA.

Most **notably**, Geter also argued that certain **in-person operations** that were temporarily performed **remotely** during the **COVID-19** pandemic **prove** that being in the office was **not necessary**.

In response, the 11th Circuit held that the "bare feasibility" of Schneider's temporary accommodations of remote work during the COVID-19 pandemic, which occurred after Geter's termination, "does not demonstrate that the function was not essential." Therefore, even though Schneider could have granted certain accommodations offered due to extenuating circumstances did not mean that it had to continue doing so.

#### Sources

- <sup>1</sup> [Mayor Adams Signs Legislation To Prohibit Height Or Weight Discrimination In Employment, Housing, An | City of New York \(nyc.gov\)](#)
- <sup>2</sup> [The Law - CCHR \(nyc.gov\)](#)
- <sup>3</sup> [NY State Senate Bill 2023-S4516 \(nysenate.gov\)](#)
- <sup>4</sup> [Bill Text - SB-848 Employment: leave for reproductive loss. \(ca.gov\)](#)
- <sup>5</sup> *Cierra Geter v. Schneider Nat'l Carriers*, No. 22-11285 (11th Cir. 2023)
- <sup>6</sup> [US Court of Appeals for the 11th District, 202211285.pdf \(uscourts.gov\)](#)
- <sup>7</sup> *United Minerals & Properties Inc. v. Phoenix Insurance Co.*, No. 4:23-cv-00050 N.D.GA. 2023)



# Financial Institutions

## Continued and Emerging Risks for Financial Institutions (FI)

After the tumult of the spring banking crisis, FIs continued to face pressure from all sides: regulators, shareholders and customers.

Eight securities lawsuits have been filed arising out of the banking crisis, including lawsuits against banks that did *not* fail: PacWest Bancorp (PWB) on September 11, 2023, and KeyCorp/KeyBank on August 4, 2023.

The PWB suit alleges that from the period of February 28, 2022, to May 3, 2023, PacWest made materially false and misleading statements, as well as failed to disclose material adverse facts. These included the failure to disclose to investors that: “(i) PacWest had understated the impact of interest rate hikes on PWB, a smaller bank with excessive concentration in specific industries; (ii) accordingly, the Company had overstated the stability and/or sustainability of its deposit base; (iii) as a result, PacWest was exceptionally vulnerable to excessive deposit flows and/or a liquidity crisis; and (iv) as a result, Defendants’ public statements were materially false and/or misleading at all relevant times.” The complaint alleges that the defendants violated Sections 10(b) and 20(a) of the 1934 Act. *Tan v. PacWest Bancorp, et al.*, Case No. 23-cv-1685 (C.D. Ca; Sept. 11 2023).

The KeyCorp/KeyBank suit alleges that KeyCorp downplayed concerns regarding its liquidity while touting the effectiveness of its long-term liquidity strategy. The complaint states that as a result, its share price declined after the bank executives stated reductions in the company’s earnings guidance, as the bank found itself required to pay higher interest rates to attract deposits.

As stated in the complaint, defendants made false and/or misleading statements and/or failed to disclose that: (i) Key downplayed concerns with its liquidity while overstating the effectiveness of its long-term liquidity strategy; (ii) Key overstated its projected net interest income (NII) for the second quarter and full year of 2023, as well as related positive NII drivers, while downplaying negative NII drivers; (iii) as a result, Key was likely to negatively revise its previously

issued NII guidance; (iv) all the foregoing, once revealed, was likely to negatively impact Key’s business, financial results and reputation; and (v) as a result, Defendants’ public statements were materially false and/or misleading at all relevant times. *Gurevitch v. KeyCorp et al.*, Case No. 1:23-cv-01520 (N.D. Ohio Aug. 4, 2023).

These suits demonstrate that even without further bank failures, banks are still under intense scrutiny and litigation risk. This is especially true around executive and board governance. Based on insurer feedback and evaluation of recently filed suits, banks and credit unions should be paying particular attention to the following issues:

- Interest rate risk
- Levels and amounts of uninsured deposits
- Percentage of broker deposits
- Sector concentration
- Exposure to commercial real estate
- Third-party risk

## Evolution of ESG

ESG as a liability risk has developed into a very different issue than originally perceived, reflecting the political polarization characterizing other social issues.

### ESG Backlash

At least 18 states have enacted some form of anti-ESG legislation; most ban use of ESG criteria when managing public retirement systems or public funds. Attorneys general of 13 states issued a warning to Fortune 100 companies, threatening “serious legal consequences” over race-based employment preferences and diversity policies. These states include Alabama, Arkansas, Indiana, Iowa, Kansas, Kentucky, Mississippi, Missouri, Montana, Nebraska, South Carolina, Tennessee and West Virginia.

Tennessee recently filed what it is calling a first-of-its-kind consumer protection action against BlackRock, Inc. *Tennessee et al. v. BlackRock, Inc.* (Williamson County, Tennessee, Dec. 18, 2023). The state’s complaint alleges that BlackRock made false or misleading representations to current and potential Tennessee



consumers about the extent to which ESG considerations affect BlackRock's investment strategies. The Tennessee attorney general, Jonathan Skrmetti, said in a statement that "We allege that BlackRock's inconsistent statements about its investment strategies deprived consumers of the ability to make an informed choice. Some public statements show a company that focuses exclusively on return on investment; others show a company that gives special consideration to environmental factors."

The lawsuit alleges that BlackRock manages over \$9T in investments. The suit alleges that as part of its investment strategy, BlackRock joined ESG coalitions such as the Net Zero Asset Managers initiative and Climate Action 100+. The suit alleges that many of its shareholder votes are intended to align companies with the aforementioned coalitions' "net zero" goals by 2050. The suit alleges that BlackRock's disclosures do not mention such promises, but rather BlackRock told consumers elsewhere that the only consideration driving its investment decisions is return on investment.

Tennessee states that "BlackRock has articulated two inconsistent positions: one focusing solely on money and the other focusing on environmental impact. Tennessee consumers deserve to know which of BlackRock's statements are a true account of the company's decision-making." This action seeks injunctive relief, civil penalties and recoupment of the state's costs.

### ESG Support

At the same time, states and federal regulators are pushing for more climate disclosures. California's Climate Accountability Package was recently passed by the California legislature and signed into law by Gov. Gavin Newsom. It requires certain disclosures for any business entity doing business in California with annual revenues of \$500M or more. Per California SB 253, the Climate Corporate Data Accountability Act, greenhouse gas emissions data disclosures are required by all business entities (public or private) doing business in California and with annual total revenues in excess of \$1B. SB 261, Greenhouse gases: climate-related financial risk, requires companies to prepare reports disclosing their climate-related financial risk and applies to companies doing business in California with annual revenues of \$500M.

On July 31, 2023, the EU Commission adopted its first set of mandatory ESG reporting standards, which could have a significant impact both within and outside the EU.

Finally, the SEC has not yet released the final version of the climate change disclosure guidelines, which the agency first proposed in October 2022. The final rules are anticipated early 2024, however.

## Emerging Technologies

The push-pull between FIs and the march of advancing technologies continues. FIs must be careful not to get ahead of regulators or their clients as they seek the advantages offered by quickly evolving technologies.

### Cyber Preparedness

In addition to the new federal and state regulations (as detailed above), FIs must be proactive in their cyber preparedness to prevent customer action. We have seen a marked increase in cyber and social engineering claims, as cybercriminals seek to manipulate new technologies to breach FIs, their vendors and their customers.

Fidelity National Financial (FNF), a Fortune 500 company that offers loan servicing and other mortgaging services, recently was named as a defendant in a California class action for its failure to implement and maintain reasonable and adequate security procedures and practices to safeguard the personally identifiable information (PII) of its customers. Its subsidiary had been victim of a data breach in August 2022, and FNF suffered a subsequent data breach in November 2023. FNF disclosed in a November 2021 filing with the SEC that it had "recently become aware of a cybersecurity incident."

The purported class action quickly followed in December, alleging that FNF had "prior notice of their inadequate data security procedures and practices" but failed to implement and maintain adequate security procedures and practices. *Tillis v. Fidelity National Financial Inc. et al.*, Case No. 5:23-cv-02537 (C.D. Cal. Dec. 12, 2023).

As stated in the complaint:

Despite the highly sensitive nature of the personal information Defendants obtained, created, and stored, and the prevalence of data breaches at financial institutions like Defendants or related businesses, Defendants inexplicably failed to implement and maintain reasonable and adequate security procedures and practices to safeguard the PII of Plaintiff and the Class. The data breach itself and information Defendants have disclosed about the breach to date, including its length, the need to remediate Defendants' cybersecurity and the sensitive nature of the impacted data, collectively demonstrate Defendants failed to implement reasonable measures to prevent the data breach and the exposure of highly sensitive customer information.

This case is an immediate demonstration of the emerging risk to FIs: customer class actions that may follow after institutions follow the new SEC cyber reporting rules.

### Peer-to-Peer Payment Platforms

A California federal judge ruled that Bank of America must face part of a proposed class action from customers who say the bank has unlawfully refused to reimburse them and others for fraud perpetrated over Zelle, the bank-owned instant payment platform.

This case is part of a broader wave of consumers who have brought class actions in recent years that accuse banks of unlawfully refusing to cover fraud losses tied to transactions on Zelle.

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## Other Notable Legal Developments from H2

In a warning case to general counsel and risk managers everywhere, a credit union must face a class action regarding improper overdraft fees after the credit union failed to register and approve its arbitration agreement before the American Arbitration Association. *Merritt Island Woodwerx LLC et al. v. Space Coast Credit Union*, Case No. 6:23-cv-01066, (M.D. Fla. Dec. 15, 2023). Here, the plaintiffs filed a purported class action complaint against Space Coast Credit Union in Florida federal court, alleging breach of contract for charging impermissible overdraft fees. The court found that Space Coast failed to perform its contractual obligations under AAA Consumer Rule 12 by neglecting to submit the arbitration agreement for pre-dispute review and pay the associated fee. As such, the court could not issue a stay or compel arbitration.

The Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency (OCC) have ordered U.S. Bank to pay almost \$36M for allegedly freezing tens of thousands of customer accounts and blocking customers from receiving unemployment benefits during COVID-19. U.S. Bank agreed to pay separate \$15M penalties to both the OCC and CFPB and \$5.7M to customers.

According to the CFPB, the bank froze accounts without providing eligible cardholders an adequate means to verify their identity, unfreeze their accounts and regain access to their unemployment benefits in a timely manner. In thousands of cases, U.S. Bank failed to provide credits because it improperly required customers to provide additional written confirmation about suspected unauthorized transfers.

The CFPB stated that U.S. Bank violated the Consumer Financial Protection Act and the Electronic Fund Transfer Act. A separate announcement from the OCC alleges the bank engaged in unfair practices under the FTC Act. *U.S. Bank National Association*, Case No. 2023-CFPB-0019, (CFPB 2023); *U.S. Bank National Association Cincinnati, Ohio*, Case No. AA-ENF-2023-64 (OCC 2023).

On August 23, 2023, the SEC enacted [new rules for private fund advisors](#) under the US Investment Advisers Act of 1940. The final rulemaking requires that all SEC-registered private fund advisors to:

- Provide investors with quarterly statements detailing fees, expenses, compensation, and performance.
- Distribute annual audits for each managed private fund, using standards similar to the Custody Rule.
- Obtain and distribute fairness opinions for advisor-led secondary transactions, including summaries of relationships with opinion providers.

Additionally, the rules impose restrictions on activities by all private fund advisors, which include:

- Disclosing regulatory fees charged to the fund and not reducing adviser clawbacks based on certain taxes.
- Equitably allocating fees related to portfolio investments and providing advance written notice.
- Prohibiting fees associated with investigations unless disclosed and consented to by fund investors.
- Forbidding borrowing from private fund clients without investor consent.

Lastly, the rules require that all SEC-registered investment advisors, including those that do not advise private funds, document their annual compliance policy reviews in writing.

# Insurance Coverage – Important Decisions and Legislation

The realm of insurance coverage saw a lot of significant activity throughout the second half of 2023.

A Georgia District Court issued a key decision in a coverage dispute regarding which facts should be considered in determining an insurer's duty to defend. The court held that the determination of a duty to defend an application of a policy exclusion should depend on the true facts of the case rather than the plaintiff's alleged facts in the complaint. This decision appears to be a deviation from the traditional way courts have determined whether a duty to defend exists: by scrutinizing the allegations in the complaint and the policy language. This is contrasted by the analysis and review to determine a duty to indemnify: examining the actual facts establishing the insured's liability.

In *United Minerals & Properties Inc. v. Phoenix Insurance Co.*, Phoenix Insurance Co. issued a duty to defend policy to United Minerals and Properties, Inc. d/b/a CIMBAR Performance Minerals.<sup>7</sup> The underlying lawsuit alleges that a CIMBAR talc product used in two medical procedures in 2014 and 2020 contained asbestos, which caused the underlying plaintiff to be diagnosed with malignant pleural mesothelioma. CIMBAR contends that its talc product does not contain asbestos, which was confirmed after its talc was tested by an independent laboratory and found not to contain asbestos. Therefore, the plaintiff's diagnosis could not have been caused by CIMBAR's talc products.

In both 2014 and 2020, Phoenix insured CIMBAR, and the policy agreements included that Phoenix would defend CIMBAR in suits seeking damages for bodily injury. However, Phoenix refused to defend CIMBAR, citing the asbestos exclusion. The 2014 asbestos exclusion provided in relevant part as follows:

This insurance does not apply to "bodily injury" ... arising out of the actual or alleged presence or actual, alleged or threatened dispersal of asbestos, asbestos fibers or products containing asbestos, provided that the injury or damage is caused or contributed to by the hazardous properties of asbestos... (Emphasis added)

The 2020 asbestos exclusion provided in relevant part as follows:

"Bodily injury" ... arising out of the actual or alleged presence or actual, alleged or threatened dispersal of asbestos, asbestos fibers or products containing asbestos, provided that the "bodily injury" is caused or contributed to by the hazardous properties of asbestos. (Emphasis added)

CIMBAR sued Phoenix seeking declaratory relief and compensatory and consequential damages for breach of contract. Phoenix filed a motion to dismiss, arguing that the asbestos exclusions unambiguously exclude the duty to defend whenever a plaintiff alleges that an injury is caused by asbestos. The District Court disagreed and denied Phoenix's motion to dismiss.

In support of its argument that the policy unambiguously excludes any claims alleging the presence of asbestos, Phoenix points the court to language present in both of the relevant policies where the exclusion states that the insurance does not apply to bodily injury "arising out of the actual or *alleged* presence ... of asbestos..." The court determined that this clause could not be read in isolation and focused on the second part of the clause: "provided that the injury *is* caused or contributed to by the hazardous properties of asbestos." The court determined that the presence of the word "is" in the clause implies that asbestos must be present for the exclusion to apply.

The court held that Phoenix must defend CIMBAR in the underlying suit if the talc products do not in fact contain asbestos, regardless of the fact that the underlying plaintiff alleged the presence of asbestos. Because CIMBAR has alleged and confirmed that its talc products do not contain asbestos, it alleged a claim upon which relief can be granted.

The state of Nevada stirred things up with the passage of Assembly Bill 398, which prohibited insurers from issuing liability policies containing a provision where defense costs coverage was within the limit of liability. As most management and professional liability insurance policies provide coverage for defense within the limits, this development put insurers, brokers and clients on edge as it would constitute a fundamental change to the underwriting and pricing for such

coverage, with the markets questioning whether or not they would be able to continue underwriting Nevada risks. Key stakeholders and industry groups, including efforts by the state insurance commissioner, appealed to the government to reconsider. The provision was later amended to clarify that it would not apply to management and professional liabilities, except for professional liability associated with providers of healthcare services.

In August 2023, a three-judge panel in the US Court of Appeals for the 1st Circuit upheld a lower court ruling granting summary judgment on behalf of an excess insurer that they were within their rights to deny a claim for late notice when the insured failed to report a claim in the same manner as required by the terms and conditions of the primary policy. The litigation was submitted to the excess insurers two-and-a-half years after the first notice of the claim was made to the primary insurer. The litigation took place in Massachusetts, where an insurance company does not have to show prejudice for late notice of a claim under a claims-made policy. Case No. 1:21-cv-11530-ADB (D. Mass. 2023).

In September 2023, a three-judge panel of the Delaware Supreme Court affirmed a lower court's ruling denying an insurance company's motion to dismiss in coverage litigation based on a denial citing a management liability policy's professional services exclusion. The insured underwrote mortgages, and in certain situations when the borrower defaulted, the insured could recover their loss from the government if the loan had been properly underwritten.

The policyholder was the target of qui tam litigation arising out of alleged violations of the False Claims Act. The insurance company denied coverage based on the professional services exclusion, arguing the broad lead-in language of that exclusion allowed them to exclude the claim as it was "based upon, arising out of, in any way relating to" their mortgage underwriting, a covered professional service as per the policy's provisions. The court held that even with the broad lead-in language, as the professional services were afforded to customers and not the government, the exclusion was not applicable. *Ace Am. Ins. Co. v. Guaranteed Rate, Inc.*, Case No. 357 (Del. 2023).

Basic **policy definitions and terms** played a **role** in another coverage dispute that fell in **favor** of an insurer.

In October 2023, the New York Supreme Court Commercial Division granted an insurance company's motion for summary judgment, finding that a "tolling agreement" was within the definition of claim and, as such, was subject to reporting requirements under a lawyers professional liability policy.

A law firm had entered into a tolling agreement with their client but did not report the matter to their insurance policy until years later when a lawsuit was filed. After initially accepting the matter under a reservation of rights, the insurance company filed a declaratory judgment action seeking a "no coverage determination" from the court. The court agreed with the insurance company, finding that the tolling agreement previously entered into was a claim and should have been reported when made. In addition, the policy also had a "no prior knowledge" provision in which the insured warranted they were not aware of any breach of a professional duty and/or were aware of a wrongful act that could give rise to a claim against them. Because the insured had entered into the agreement prior to date in the policy, it was reasonable to foresee a claim being made against them and, as such, was in violation of this provision as well. *Allied World Assurance Co. (U.S.) v. Golenbock Eiseman Assor Bell & Peskoe, LLP*, 2023, N.Y. Slip Op. 33840 (N.Y. Sup. Ct. 2023).

Returning to Delaware for a final significant 2023 coverage decision, the Delaware Supreme Court had to consider whether or not a fraudulent transfer action brought by a bankruptcy trustee was considered a derivative claim and, as such, would meet the definition of "securities claim" under the insurance policy. The Delaware Superior Court had previously ruled the trustee's action was a derivative claim and found the trustee to be a security holder who was bringing the litigation on behalf of the company.

On December 15, 2023, the Delaware Supreme Court disagreed and reversed the ruling, holding that the trustee's fraudulent transfer claims were direct and not derivative, as understood by securities and corporate law, and therefore were not "securities claims" within the meaning of the policies. The Supreme Court concluded the underlying claims were direct because "the creditors suffered the harm by the fraudulent transfer, and the remedy benefits the creditors, not the business entity." The court added that "a business entity's insolvency does not convert direct claims like fraudulent transfer claims into derivative claims." *Verizon Commc'ns Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, C.A.* Case No. N18C-08-086 EMD CCLD (Del. Super. Ct. 2023).

As are the cases for most of these decisions, the particular facts at issue weigh significantly in the courts' decisions.



# Meet the Experts — **Contacts**



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