Following an excellent discussion at our April committee meeting of recent federal and state law developments affecting officer and director liability, members of our committee have been at work not only disseminating important information regarding case law developments but also promoting efforts to ensure directors and officers are fully protected in their board and company service.

I was privileged to moderate our section's first 2014 podcast titled "Attorney-Client Privilege: Implications for Officers and Directors" with panelists Peter B. Ladig, Esq., a litigation partner at Morris James LLP in Wilmington, DE and John Mark Zeberkiewicz, Esq., a transactions partner at Richards, Layton & Finger, P.A. in Wilmington, DE. The panel addressed such questions as whether the privilege is waived if an officer or director communicates to his or her personal counsel on a company server (it may be), whether otherwise privileged communications with company counsel must be disclosed to a stockholder making a demand under Section 220 for books and records to investigate alleged breach of fiduciary duty regarding an internal investigation (they were required to be disclosed in one recent case affirmed by the Delaware Supreme Court), and whether privileged communications regarding a merger transaction pass to the buyer once the merger closes (they do unless otherwise contracted for). For more information, please listen to the podcast available on the D&O Committee ABA website.

Following our initiative to assist directors and officers to secure advancement rights before they become subject to formal proceedings and preserve their critical Fifth Amendment privilege, the Corporate Laws Committee has acted to modify the Model Business Corporation Act. Specifically, a proposed amendment deletes the Model Act's current requirement that an executive must make a written, cross-examinable assertion of innocence of breach of fiduciary duty as a condition of obtaining advancement, even though the advancement right is contractually mandatory. The proposed amendment was circulated for comment in the May Business Lawyer. Members of our committee, and in particular Jim Wing, Esq. of Holland & Knight, chair of our D&O Insurance subcommittee, have been active supporters of this amendment.

I hope to see you at the annual meeting of the Business Law Section in Chicago. Our committee will meet on Friday, September 12 at 10:00 a.m. If there are topics about which you have an interest in presenting a podcast or webinar, do not hesitate to contact me directly.

Lewis H. Lazarus
Morris James LLP
Chair, Directors and Officers Liability Committee
ABA Business Law Section
having their actions questioned by regulators and other law enforcement authorities. Less well known to the executives of these businesses (despite wide publication) is the concept of the "corporate internal investigation." To escape or mitigate legal responsibility for actions of its employees or executives, the company hires outside counsel to conduct an internal investigation. This is today the preferred means of investigating behavior that may be legally troubling for the involved company.

The facts and allegations that give rise to an internal investigation can reach the attention of the company's chief legal officer, senior management, or board in any number of ways. They may be communicated from a wide variety of sources, some of them informal. These investigations, by their very nature, commence without there being a specific charge of misconduct against any specific individual and even without there having been first identified a discrete alleged wrongful act. Almost invariably, however, the investigation involves potential violations of criminal law. Raising the stakes is today's public clamor for corporate agents to be brought to justice for criminal misconduct and the general recognition that innocent shareholders should not pay for the defense costs, much less the penalties, that are incurred by corporate agents who are viewed in hindsight as having implicated the company in violations of criminal law.

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**Supreme Court Rules That Securities Fraud Defendants Can Rebut Presumption of Reliance at Class Certification Stage**

*By Courtney E. Scott and Kyle P. Barrett*

In a much-anticipated decision, the U.S. Supreme Court declined to overrule *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which established the fraud-on-the-market presumption of reliance for private securities fraud actions, but held that defendants may rebut the presumption of reliance at the class certification stage with evidence that a defendant's alleged misrepresentation did not impact a company's stock price. *Halliburton, Co. v. Erica P. John Fund, Inc.*, 573 U.S. ____ (2014).

Erica P. John Fund, Inc. (EPJ Fund) filed a putative class action against Halliburton Co. and one of its executives (Halliburton), alleging violations of Section 10(b) of the Securities Exchange Act of 1934, which prohibits making any material misstatement or omission in connection with the purchase or sale of any security. EPJ Fund alleged that between June 3, 1999, and December 2001, Halliburton made a series of misrepresentations in an attempt to inflate the price of its stock. Subsequently, Halliburton made corrective disclosures which caused the stock price to drop and investors to lose money.

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**Addressing Cybersecurity Risk in the Board Room**

*By Frances F. Goins*

As the pace and extent of data breaches of U.S. companies continues to accelerate, corporate directors have become more aware of the attendant risks not only for their companies, but for themselves. Unfortunately, however, despite the escalating costs associated with such incidents, this increased attention has not uniformly translated into appropriate risk management policies and procedures. Regulators have taken notice of the disparity, and cybersecurity has become a priority of both the Securities and Exchange Commission (SEC) and the Department of Homeland Security (DHS).

According to a recent release by EisnerAmper LLP reporting on a survey of responses from directors of more than 250 boards, reputational risk and cybersecurity are the two major concerns (aside from financial risk) of directors of public companies. Respondents recognize that these risks are interconnected, since a speedy response to a breach can be critical to reputation. "Social media enable these reputation issues to take on a life of their own, both in terms of viral dispersion as well as uncontrollable timeline, with a footprint that is almost impossible to erase." Yet, close to a quarter of respondents had no plans to address data breaches when they occur, and others stated they were just informally "doing their best."
Update on Advancement and Indemnification Issues and the Model Business Corporation Act

You may find the proposed revision to the advancement and indemnification provisions of the Model Business Corporation Act here that appeared in the May edition of The Business Lawyer for comment by the profession. The revision and its comments delete the requirement that an executive make a cross-examinable assertion of innocence of breach of fiduciary duty as a condition to obtaining advancement. It was our committee that first pointed out to the Corporate Laws Committee how detrimental this was to any executive whose conduct could be construed as potentially giving rise to criminal exposure because the assertion was effectively conditioning the right to advancement on a Fifth Amendment waiver.

This amendment conforms the Model Act to Delaware law, which does not statutorily require such an assertion as a condition to advancement.

Deleted from this Model Act comment is express reference to Advanced Min. Systems, Inc. v. Fricke, 623 A.2d 82 (Del. Ch. 1992) decision found here, holding that no executive has a mandatory right to advancement unless that right is expressly set forth in a contract, by-law, or certificate of incorporation. The Comment, however, still repudiates that view and refers to another section of the Model Act stating that when a corporation grants "indemnity to the fullest extent of the law" (the usual term) or equivalent, that grant of indemnity automatically includes a right to advancement. Therefore, DE law and the Model Act still depart from one another on that important point.

The comment also strongly encourages practitioners to look at the governing documents of their client corporations to make sure that the board’s intentions concerning advancement and indemnity are appropriately reflected in the corporation’s governing documents. They almost never are, or the corporations are employing forms that have never been reviewed carefully on this critical issue so that they do not reflect a reasoned decision by the board. At the same time, D&O insurance coverage remains non-existent, spotty, or uncertain as to the early attachment of advancement cover.

No adverse comments were received after publication of this amendment. The language will go to third reading in September.

Our committee welcomes this action and congratulates the Committee on Corporate Laws.

Also, in case you missed it, the Delaware Court of Chancery recently addressed the rights to advancement and indemnification for a corporate officer - click here
Panel Presentation on April 12, 2014 in Los Angeles at ABA Business Section Spring Meeting:
“Directors, Officers, and In-House Counsel: You Think You're Covered, But You're Probably Not (And What To Do About It)”

No one these days doubts that businesses of all kinds face increasing risk of having their actions questioned by regulators and other law enforcement authorities. Less well known to the executives of these businesses (despite wide publication) is the concept of the “corporate internal investigation.” To escape or mitigate legal responsibility for actions of its employees or executives, the company hires outside counsel to conduct an internal investigation. This is today the preferred means of investigating behavior that may be legally troubling for the involved company.

The facts and allegations that give rise to an internal investigation can reach the attention of the company’s chief legal officer, senior management, or board in any number of ways. They may be communicated from a wide variety of sources, some of them informal. These investigations, by their very nature, commence without there being a specific charge of misconduct against any specific individual and even without there having been first identified a discrete alleged wrongful act. Almost invariably, however, the investigation involves potential violations of criminal law. Raising the stakes is today’s public clamor for corporate agents to be brought to justice for criminal misconduct and the general recognition that innocent shareholders should not pay for the defense costs, much less the penalties, that are incurred by corporate agents who are viewed in hindsight as having implicated the company in violations of criminal law.

For over two years, the Director & Officer Liability Committee has focused on whether the existing framework of statutory law, case law, insurance coverage, and court practices and attitudes are dealing effectively with the corporate internal investigation and the attendant criminalization of executive conduct. This year, the Director & Officer Liability Committee combined forces with three other Committees of the Business Law Section of the ABA -- Corporate Governance, Private Equity and Venture Capital, and Corporate and Business Litigation -- to sponsor a two-hour session to bring the profession up to date on these efforts. Five panelists with diverse perspectives shared observations, personal experience, and expertise before, during, and after the program.¹ This was truly a knowledgeable and experienced group.

¹ The panel was moderated by James Wing of Holland & Knight Miami and Chicago. Jim is a frequent speaker and author on this subject in specialty insurance publications and has actively litigated advancement rights for executives under criminal law scrutiny. He is currently the chairman of the D&O Insurance Subcommittee of the Director & Officer Liability Committee.

Francis Pileggi of Eckert Seamans Wilmington and Nancy Adams of Mintz Levin Boston are co-chairs of the Indemnification and D&O Insurance Subcommittee of the Corporate and Business Litigation Committee. Nancy regularly advises primary and excess insurance carriers in a variety of contexts and has extensive experience in D&O risk management, advancement and indemnity by-law drafting, and auditing executive protection programs. Francis is the noted creator of the respected Delaware Corporate and Commercial Litigation Law Blog (www.delawarelitigation.com) who regularly updates the profession on developments in this area. Francis also litigates cases involving advancement and indemnity.

Leslie Kurshan is a member of the California bar and a solicitor of England and Wales. Based in London, she is head of product development for the UK financial and professional lines practice of Marsh (the world’s largest insurance broker). Leslie is a former insurance coverage litigator, experienced at negotiating and drafting D&O policies for companies in the U.S. and Europe.
In preparation, the panel assessed all recent ABA publications on point, including the 2012 and 2013 Checklists for Corporate Counsel Supervising the Creation or Renewal of an Executive Protection Program, the 2013 Annotated Model Indemnification Agreement, and the chapter on indemnification and advancement contained in the ABA’s “2014 Edition of Recent Developments in Business and Corporate Litigation.” The panel also reviewed an in-depth discussion of the Fifth Amendment to the U.S. Constitution as it applies to executives involved in corporate internal investigations and a 52-jurisdiction survey of the law relating to corporate advancement of litigation expenses (both distributed in the program materials), as well as other relevant materials, including the publications set out in the panelists’ resumes and cited in them.

The panel’s conclusions were neither pretty nor comforting to hear. The panel broke down its presentation by addressing separately each of the three elements of an acceptable executive protection program -- underlining that each of the three elements must be separately considered and then coordinated with the other elements: exculpation statutes, advancement and indemnification provisions of articles of incorporation, by-laws, or agreements, and D&O insurance. The conclusions of their coordinated presentations were as follows:

1. **Exculpation.** Almost all state statutes have a provision authorizing corporations formed under them to include a provision in their articles/certificate of incorporation insulating their directors (rarely do the statutes include officers) from liability for damages based on the breach of the fiduciary duty of due care (as opposed to the duty of loyalty). The charters of many (usually non-public) corporations lack such a provision, and under present political circumstances, it is frequently difficult to get one inserted into an existing charter. Court decisions vary as to whether a defense based on such a statute can be raised in litigation by a motion to dismiss or only as an affirmative defense, with the states adopting the latter view significantly reducing the utility of such protection because in those jurisdictions the provision may not be sufficient to avoid expensive discovery.

   Bottom Line: A lawyer creating or renewing an executive protection program should determine whether the corporation’s charter has such a clause and, if not, advise the client appropriately.

2. **Advancement of Defense Costs -- Does the Executive Have an Enforceable Right to Advancement At All?** The “corporate internal investigation” has become the criminal law’s instrument of choice that can place interviewed executives in a legal quagmire fraught with risk. An interviewed executive without funding to secure immediate access to experienced counsel faces potentially catastrophic familial, personal, career, and financial loss. The panel emphasized the absolute need for executives to have secured in advance of the investigation a mandatory right to advancement from the company of his/her defense costs, repayment of which can be compelled by the company only if the executive is found to have acted in bad faith or to have acted contrary to the company’s interests in respect of the underlying matter without a reasonable belief that s/he

Based in Dallas, Kara Altenbaumer-Price is the head of management and professional liability counseling for USI ~ the nation’s largest privately-held insurance broker. She was formerly a securities litigator and frequently counsels USI’s clients on “employed lawyer” coverage for in-house counsel, including those who are not simultaneously corporate officers.

2 In Delaware, however, exculpatory provisions are customary and appear in the certificate of incorporation of most corporations, whether public or non-public.

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was acting appropriately. It is the job of drafting counsel to deliver that protection, assuming that the company’s board has decided to grant it. (Corporate boards, once advised of the law, rarely decline to provide advancement rights to directors and officers.)

It was emphasized that Delaware law (and presumably that of the twelve other U.S. jurisdictions that are considered to follow Delaware in this area) does not mandate advancement unless the right is specifically granted in the company’s by-laws, certificate of incorporation, or a separate agreement. Granting executives mandatory “indemnity to the fullest extent permitted by law” or other such general language is not sufficient to assure advancement in Delaware-pattern jurisdictions. In stark contrast, fourteen jurisdictions follow the current Model Business Corporation Act and reject the Delaware rule. Those jurisdictions’ statutes specifically provide that a grant of mandatory indemnity rights alone includes a right to mandatory advancement without further specificity. This means that in the remaining twenty Model Act-based states that omit the language explicitly rejecting the Delaware rule, it can be argued that the omission of the rejection implies that the Delaware rule has been adopted so that executives who are merely “indemnified” have no right to mandatory advancement.

The 52-jurisdiction summary appended to the program materials catalogs these and other potential statutory impediments to advancement in the various jurisdictions. Delay in advancement resulting from having to litigate these questions alone can seriously harm an executive who needs immediate assistance.

Bottom Line: Practitioners need to draft advancement and indemnification provisions of charters and by-laws or agreements with sensitivity to these issues and may consider lobbying their Bar representatives to the state legislatures to keep up to date through potential amendments to their state’s corporate law statutes.

3. Advancement of Defense Costs – “Final Adjudication.” Equally striking are the differences among the states on the critical issue of what is known as “final adjudication.” Delaware lawyers report that in practice, a company that wishes to oppose a qualified, entitled executive’s demand for advancement may not file affirmative defenses, counterclaims, or even independent suits that force the executive to litigate facts relevant to an alleged breach of fiduciary duty that might ultimately disentitle him to indemnity until and unless there is a “final adjudication” in the underlying case or (perhaps) a final judicial finding in another case or sworn admission of facts that constitute disabling misconduct. While this means, in common law parlance, that the duty to advance defense costs remains no broader than the duty to indemnify, breach of the latter duty may not be determined before there is a ruling in the underlying (civil or criminal) case.

Query whether the same rule will necessarily be followed by courts in other Delaware-pattern states or, for that matter, non-Delaware courts asked to apply Delaware law? For sure it will likely not be followed in the three Delaware-pattern states that, consistent with the current Model Act, require the executive to provide a written profession of innocence of breach of fiduciary duty. Only a few states have even considered this issue, much less decided it.
Bottom Line: Practitioners should write a “final adjudication” provision into any advancement or indemnification charter or by-law provision or agreement intended to confer mandatory advancement. This is true even for Delaware practitioners whose advancees may need to seek court relief under Delaware law in jurisdictions outside of Delaware.

4. Advancement of Defense Costs--Fifth Amendment Complications. As noted above, the principal goal of the program was to explore the interaction between the criminal law as applied in corporate internal investigations and the advancement rights of indemnified executives. Even a completely innocent executive, when interviewed in an internal investigation, takes significant legal risks of which he is not generally aware. The panel demonstrated that he is given an “Upjohn Warning” (not a Miranda Warning), not to advise him of his rights, but to guarantee that what he says may be disclosed by the company’s private counsel to governmental authorities or prosecutors. The panel graphically posited a hypothetical where an innocent executive is first notified in the investigation that he has been (falsely) accused of criminal wrongdoing by a subordinate employee. The panel explained how both his verbal and nonverbal reactions to the accusation can be used against him later in court. The panel demonstrated the quandary in which he is placed and that even a decision to invoke Fifth Amendment rights in that context must be express or is waived under a recent 5-4 decision of the U.S. Supreme Court. *Salinas v. Texas*, -- U.S. --, 133 S.Ct. 2174 (2013).

The panel further pointed out that merely denying the (false) allegation would constitute a Fifth Amendment waiver and is thus anathema to experienced white collar defense counsel. This is because a premature denial of liability can be highly disadvantageous to the innocent indemnified executive’s legal interests. If he fails to respond at all or if he asserts Fifth Amendment rights, the panel explained that he can be, and probably will be, fired with all the personal, career, and financial damage that a termination entails. If he were a government employee, he could not be terminated unless he were first granted immunity and still refused to talk. As an employee of a private company, he has no such Constitutional protection. All these issues are explored in more detail in the Fifth Amendment memo contained in the program materials.

But all the news is not bad. The statutes of Delaware-pattern jurisdictions (except for the three that require the putative advancee to testify as to his innocence of breach of fiduciary duty) do not expressly condition advancement on the executive’s assertion of innocence. Thirty-one Model Act jurisdictions, however, impose the assertion of innocence requirement by statute, as does New York and New Jersey by implication. However, the panel was pleased to announce that an amendment to the Model Act has been approved on second reading by the Corporate Laws Committee to delete the requirement from the Model Act; the proposed deletion will be submitted to the ABA membership for comment in the May edition of *The Business Lawyer*. Of course, even if approved by the ABA, it may be years before the change is adopted by many states that follow the Model Act.

Bottom Line: Support for the Model Act amendment is crucial for those who wish to see greater clarity of executives’ advancement rights. In the meantime, practitioners should draft charter and/or by-laws or agreements that provide rights to advancement in a way that will not impair the advancee’s Fifth Amendment rights. Even if the state of incorporation omits the requirement, you rarely have control over which state’s courts will be called upon to decide the issue.
5. Can D&O Insurance Cure Certain Uncertainty With Respect To Advancement Reflected in the Common Law of Advancement? As detailed above, the common law of advancement does not have a uniform approach across jurisdictions. One would think that D&O insurance would spring to the rescue and write cover to insure executives against these deficiencies and complications. The panel’s conclusion was that it does not, at least completely, but that relief is on the way.

The panel explained the topsy-turvy growth and proliferation of covers in this area and furnished a chart demonstrating the current interaction of covers known as A-Side, B-Side, C-Side (when combined, ABC), towers of “follow-form” and sometimes non-follow-form excess cover, and specialty covers called “Side-A only difference-in-conditions” (DIC) cover. It was explained how the definition of “Claim” in most current policies requires, typically, a written complaint, criminal charge, maybe a Wells Notice, maybe a request for a statute of limitations tolling agreement, maybe a subpoena, and maybe a request for an interview by a recognized “enforcement authority” or one incident to a corporate derivative demand. But almost never does a policy define a “Claim” to include a “pure” corporate internal investigation initiated before any claim is made against anyone. The panel explained how the definition of “Claim” also invariably includes the allegation of a discrete “wrongful act” by the insured executive, also something by definition not involved in a corporate internal investigation. Thus, most of today’s policies fail to cover the principal catastrophic risk that today’s executives most commonly face.

But there was good news. The panel reported that two DIC policies currently on the market and a third to be soon announced have expanded the definition of “Claim” to include facts that form the basis of what is called a “notice of circumstance.” The latter is a concept heretofore used in insurance policies only to cement cover under a particular policy year for matters that may not ripen into a defined “Claim” until a later year when the D&O coverage may be non-existent or reduced. The two (and soon three) DIC policies effectively attach coverage earlier than other policies on the market so as to cover “pure” internal investigations without subjecting the insured to the risk that his/her failure to notify the item to the carrier will give the carrier a late notice defense.

This is a major and positive development. Still to be resolved (although a resolution is hopefully in process) is a means to protect an insured executive from losing his/her cover for breach of the policy’s cooperation clause if s/he or counsel is required to assert legal privileges against the insurance company for fear that communicated information can be subpoenaed by an adversary.

**Bottom Line:** Advise your boards of the coverage gaps in policies under their consideration, recommend DIC cover, and be sure the cover includes the “notice of circumstance = claim” feature described above. Remember, even if the form does not have the cover, it can be negotiated into the cover. The forms on the market are not exclusive representations of what can be achieved.
6. In-House Counsel Exposure. The panel was unable to give comfort to employed lawyers in terms of their ability to obtain advancement and indemnity from their own corporate clients under state Bar rules that prohibit lawyers from obtaining indemnity from clients for their own misconduct. It was further noted that most D&O policies that cover general counsel as a corporate officer exclude liability for professional services, thereby reducing D&O coverage for them and motivating them to obtain separate “employed counsel” coverage. Further uncertainty can arise in those cases (fortunately rare) where “employed counsel” are accused of conspiring with or aiding and abetting an allegedly miscreant corporate officer. In those cases, it is important that the employed lawyer’s policy cover all actions taken in the process of rendering legal advice, and not be limited strictly to professional negligence.

Bottom Line: Give careful attention to the policy language to be sure that “all risk” coverage for employed lawyers is obtained to the maximum extent possible.

7. Implications for Legal Ethics. Included in the program materials was the D&O Liability Committee’s “2013 Checklist for Corporate Counsel Managing the Creation or Renewal of an Executive Protection Program.” The Checklist attempts to catalog all the issues of exculpation, advancement and indemnity, and D&O insurance known on the date of its publication. New issues have already arisen since then and will be included in next year’s version. The current Checklist is intended to provide a “best practice” safe harbor. It also raises the question of counsel’s potential conflict in advising simultaneously the company’s board, members of which may be advancees/indemnitees, and in its capacity as counsel for the company itself. It resolves the conflict by acknowledging that one exists but pointing out that the conflict is that of the board itself, not that of counsel. This is because it is the statutes that put the board in the position of authorizing the company to grant mandatory advancement and indemnity so that the company may obtain and retain qualified personnel.

But as the advancement rights of executives are broadened and clarified through statutory and drafting improvements, is the answer so obvious? Can counsel managing or supervising the process remain completely objective when advising about advancement rights for executives who may be sued by the company itself for improper personal gain, or when advising on whether advancement rights should be limited, say, to a percentage of the insurance cover so as not to threaten the solvency of the company once insurance cover is exhausted? Should any one lawyer be compelled to advise a company on executive protection when one of its principal objectives is to decide how to handle the relationship between parties whose interests can become so starkly adverse? Can any lawyer be reasonably asked to put him - or herself in a position of being subject to later criticism that s/he led the overall board to a solution that to them seems so wrong in hindsight? Is this fair to the lawyer?

And how does any one counsel deal with the question of which executives should have separate cover to avoid their policy limits being exhausted by other accused (and no doubt disfavored and maligned) inside directors who become the targets of governmental prosecution, leaving the former exposed? Should the concept of “suitcase” cover be encouraged, whereby each director obtains separate cover for a single premium that covers his liability as a member of a board or of number of different boards, to which each company for which s/he is a director contributes?
To what extent is corporate counsel obliged to even raise these issues? And how does all of this affect the non-profit area whose boards are populated by wealthy individuals who are seriously exposed to claims but where the entity itself cannot be seen by charitable donors as using its assets to pay legal defense costs in derogation of its overall charitable mission?

*Bottom Line: The panel leaves these issues of basic policy and legal/positional conflicts for future review.*
Supreme Court Rules That Securities Fraud Defendants Can Rebut Presumption of Reliance at Class Certification Stage

Authored by: Courtney E. Scott, Partner in the New York Office
Kyle P. Barrett, Associate in the New York Office

In a much-anticipated decision, the U.S. Supreme Court declined to overrule Basic Inc. v. Levinson, 485 U.S. 224 (1988), which established the fraud-on-the-market presumption of reliance for private securities fraud actions, but held that defendants may rebut the presumption of reliance at the class certification stage with evidence that a defendant’s alleged misrepresentation did not impact a company’s stock price. Halliburton, Co. v. Erica P. John Fund, Inc., 573 U.S. ____ (2014).

Erica P. John Fund, Inc. (EPJ Fund) filed a putative class action against Halliburton Co. and one of its executives (Halliburton), alleging violations of Section 10(b) of the Securities Exchange Act of 1934, which prohibits making any material misstatement or omission in connection with the purchase or sale of any security. EJP Fund alleged that between June 3, 1999, and December 2001, Halliburton made a series of misrepresentations in an attempt to inflate the price of its stock. Subsequently, Halliburton made corrective disclosures which caused the stock price to drop and investors to lose money.

To recover damages for violations of Section 10(b) and Rule 10b–5, a plaintiff must prove “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 133 S. Ct. 1184 (2013). In Basic Inc. v. Levinson, 485 U.S. 224 (1988), the Supreme Court held that investors could satisfy the reliance requirement through a “fraud-on-the-market” presumption of reliance, i.e., a presumption that the price of stock traded in an efficient market reflects all public, material information including material misrepresentations. However, the Basic Court also held that a defendant could rebut the presumption by showing that the alleged misrepresentation did not actually impact the stock price.

EJP Fund moved to certify a class of all investors who purchased Halliburton common stock during the class period. The Halliburton case was previously before the Supreme Court on the issue of loss causation, with the District Court and Fifth Circuit having denied class certification after accepting Halliburton’s argument that the plaintiffs had failed to demonstrate loss causation. 131 S.Ct. 2179 (2011). The Supreme Court reversed and remanded the case, holding that plaintiffs were not required to prove loss causation at the class certification stage. On remand, Halliburton attempted again to defeat class certification by arguing that it had demonstrated that its alleged misrepresentations had no “price impact” on Halliburton stock, thus rebutting Basic’s presumption that the proposed class relied on the alleged misrepresentations. Halliburton argued that without the Basic presumption, investors would need to prove reliance on an individual basis and thus, class certification should be denied on the basis that individual issues would dominate over common ones. The District Court rejected Halliburton’s argument and the Fifth Circuit affirmed.
The Supreme Court granted certiorari to decide whether to overturn *Basic* and whether securities fraud defendants may attempt to rebut the *Basic* presumption at the class certification stage with evidence of a lack of price impact, or whether such evidence could be introduced only during proceedings on the merits. The majority of the Supreme Court was unwilling to overrule *Basic*’s presumption of reliance, noting that Halliburton’s statutory analysis and reliance on changes in economy theory regarding the “efficient market” theory failed to show “special justification” for overturning the long-standing case.

Halliburton fared better with its arguments that the presumption of reliance on alleged affirmative misstatements is properly addressed at the class certification stage. Halliburton argued that plaintiffs should be required to demonstrate that a defendant’s misrepresentation actually affected the stock price in order to invoke the *Basic* presumption. The Supreme Court rejected that alternative, noting that requiring plaintiffs to prove price impact would “radically alter the required showing for the reliance element of the Rule 10b–5 cause of action.”

The Supreme Court did accept Halliburton’s argument that defendants “should at least be allowed to defeat the presumption at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price.” The Supreme Court noted that courts typically allow defendants to introduce such evidence to rebut the *Basic* presumption only at the merits stage, but that plaintiffs often introduce such evidence at the class certification stage to show that the stock at issue trades in an efficient market, a prerequisite for application of the *Basic* presumption. Given that plaintiffs are allowed to use price impact evidence to show market efficiency at the certification stage, the Court reasoned that it “makes no sense” to restrict defendants from relying on price impact evidence to rebut the presumption altogether at the class certification stage. The Supreme Court stated that “[w]hile *Basic* allows plaintiffs to establish that precondition indirectly, it does not require courts to ignore a defendant’s direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock’s market price and, consequently, that the *Basic* presumption does not apply.”

In an opinion concurring in judgment, Justice Thomas, joined by Justices Scalia and Alito, argued that *Basic* should be overruled, stating that “[l]ogic, economic realities, and our subsequent jurisprudence have undermined the foundations of the *Basic* presumption.”

**Tressler Comments**

The impact of the *Halliburton* decision remains to be seen at this point. Most commentators agree that a decision overruling *Basic* would have materially altered the landscape for Rule 10b–5 litigation, and potentially have impacted the market for D&O insurance, at least in the short term. The course selected by the Supreme Court in allowing D&O defendants to rebut the *Basic* presumption at the class certification stage will likely result in an increase in defense costs in the earlier stages of securities litigation, while the parties litigate over the presumption of reliance. Ultimately, we would not expect major shifts in coverage or pricing of D&O insurance, although some changes are likely as the impact of the decision begins to be seen in trial courts.
Addressing Cybersecurity Risk in the Board Room

As the pace and extent of data breaches of U.S. companies continues to accelerate, corporate directors have become more aware of the attendant risks not only for their companies, but for themselves. Unfortunately, however, despite the escalating costs associated with such incidents, this increased attention has not uniformly translated into appropriate risk management policies and procedures. Regulators have taken notice of the disparity, and cybersecurity has become a priority of both the Securities and Exchange Commission (SEC) and the Department of Homeland Security (DHS).

According to a recent release by EisnerAmper LLP reporting on a survey of responses from directors of more than 250 boards, reputational risk and cybersecurity are the two major concerns (aside from financial risk) of directors of public companies. Respondents recognize that these risks are interconnected, since a speedy response to a breach can be critical to reputation. “[S]ocial media enable these reputation issues to take on a life of their own, both in terms of viral dispersion as well as uncontrollable timeline, with a footprint that is almost impossible to erase.” Yet, close to a quarter of respondents had no plans to address data breaches when they occur, and others stated they were just informally “doing their best.”

“Doing their best” may not be enough in today’s atmosphere of increasing by serious data breaches. The Identity Theft Resource Center identified 431 total breaches exposing over 11 million records in the first seven months of 2014. Most of the breaches involved businesses – primarily retailers like Target Corp., which was the subject of a number of derivative actions earlier this year on account of its board’s handling of a major data breach late in 2013. The EisnerAmper survey noted that overwhelmingly “C-Suite executives and the Board were referenced as the go-to resources to execute a plan to preserve a company’s reputation during a crisis,” yet directors readily admitted “their lack of understanding of new media and cyber issues – two areas in which mere general knowledge can miss the critical nuances necessary for effective strategic and operational decisions.” One respondent noted that most “directors cannot spell IT.”

These issues have caused significant concern to shareholders, as evidenced not only by newly filed derivative litigation, but also by the position taken by Institutional

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1 http://blogs.absolute.com/blog/cost-data-breach-continues-rise/
3 Identity Theft Resource Center, 2014 Data Breach Category Summary (7/29/2014)
Shareholder Services (ISS) in recommending the removal of Target’s chair and other directors who, ISS alleged, failed “to provide sufficient risk oversight” relating to the cyber-theft of customer credit card information.

Recently, SEC Commissioner Luis A. Aguilar spoke on the topic of *Boards of Directors, Corporate Governance and Cyber-risks: Sharpening the Focus* at a New York Stock Exchange conference titled “Cyber Risks and the Boardroom.” In line with the EisnerAmper results, Commissioner Aguilar noted that “cybersecurity has become a top concern of American companies, financial institutions, law enforcement, and many regulators.” Commissioner Aguilar focused his remarks on “what boards of directors can, and should, do to ensure that their organizations are appropriately considering and addressing cyber-risks.” He emphasized that the board’s role was primarily one of oversight: “[B]oards are responsible for overseeing that the corporation has established appropriate risk management programs and for overseeing how management implements those programs.” These comments harkened back to the SEC’s 2009 proxy risk disclosure requirements, which stated that “risk oversight is a key competence of the board.” Commissioner Aguilar noted that 2013 proxy filings by companies comprising the S&P 200 revealed that the full boards of these companies are “nearly universally” taking responsibility for risk oversight.

Commissioner Aguilar advised boards to consider a number of changes to deal with cyber-risk management, including:

- Proactively focusing on structural changes, including mandatory cyber-risk education for directors, adequate representation by board members with a good understanding of information technology risks, and a separate enterprise risk committee of the board;
- Identifying appropriate personnel to manage cyber-risk and provide appropriate reports to the board; and
- Establishing a cyber-risk management program, including identifying personnel who are primarily responsible to respond to a cyber-attack and developing a well constructed and deliberate response plan, as well as

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company’s web services from France to the U.S., allegedly disrupting services, compromising client security, and facilitating hacking; violation of European data-privacy laws held to adequately plead a claim for breach of duty of loyalty under Delaware law).

5 http://www.sec.gov/News/Speech/Detail/Speech/1370542057946
identifying “whether, and how, the cyber-attack will need to be disclosed internally and externally (both to customers and investors).”

Meanwhile, the DHS has held a number of working meetings to discuss cybersecurity, including a July 2014 Insurance Industry Working Session, which resulted in a number of useful suggestions for creating appropriate insurance vehicles to protect companies and directors from the fallout of the data breaches. Many insurance policies currently except liability for losses resulting from a violation of a “right of privacy,” and so might not cover data breaches. As a result, the industry is attempting to structure new products that would more adequately meet current needs in this area. The participants at the conference discussed addressing cybersecurity in the context of broader ERM initiatives, appearing to view more generalized ERM insurance policies as the best vehicle to address the costs associated with data breaches. Nevertheless, they recognized barriers to successful ERM programs, particularly for mid-size and smaller companies, including lack of resources, fear of having to address cyber vulnerabilities that might be revealed, communications breakdowns between IT and non-IT security professionals who “use very different language to express basic risk concepts,” and difficulties associated with extending in-house ERM programs to vendors. One insurance industry participant suggested that the SEC could positively influence this process by integrating more mature ERM-related best practices into existing regulatory regimes for public companies.

As have previous commentators, both Commissioner Aguilar and the DHS insurance industry panel noted the impossibility of applying a “one-size-fits-all” approach to managing cybersecurity. For directors, this means that only a role-up-your-sleeves, individualized approach tailored to each particular entity can be successful to manage potential fiduciary liability exposure in the long term.

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