WHAT DOES DIVERSITY AND INCLUSION MEAN AT PLUS?
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There certainly is a lot going on in the industry and with your association. So, with all that is happening it seemed only fitting that this would be the largest PLUS Journal ever. With articles on cyber, securities, data breaches, litigation, and malpractice, there is something in this issue for just about all PLUS members. A huge thank you to all the article authors.

This issue of the PLUS Journal highlights some of the initiatives and efforts PLUS has taken toward diversity and inclusion. As an organization, PLUS is committed to creating a welcoming environment for everyone in the PLUS Community, including while participating at PLUS events. This issue highlights some of the individuals who are currently leading PLUS’s D&I initiatives and participating in the PLUS Leadership and Mentorship Program (LAMP). Now entering its fourth cohort, LAMP continues to exemplify PLUS’s D&I efforts and encourages leadership opportunities for traditionally underrepresented groups. Also, check out the article on some of the current D&I academic research.

In this issue, you will also find a sampling of the things PLUS is doing to continue to build momentum on behalf of the industry and industry professionals. Here’s just a few you will find in this issue:

**PLUS Week** – In what will become an annual event, PLUS will be celebrating the professional liability insurance industry during the third full week of September (Sept 16-20). To celebrate this year, PLUS is offering a career development webinar series; a free webinar on having difficult conversations in a raising rate environment; discounts on its newly released on-line curriculum modules; many PLUS Chapters will be hosting events either during the week or in the week before or after; and much more.

**PLUS Conference** – You should attend the PLUS Conference November 11-13 at National Harbor, Washington DC! The venue and location are phenomenal. The education is outstanding. There are great keynotes. It’s a place to meet all your colleagues, make new contacts and do business. And, if you need to, you can even knock out some CE credits.

**Sponsorships** - PLUS puts on industry-leading, high-quality educational and networking events and keeps prices down due in large part to the support of its sponsors. You will find PLUS’s annual Diamond Sponsors highlighted throughout this issue. Thank you to all these sponsors as well as those sponsors who support PLUS national and local events.

**PLUS Foundation** – As the charitable arm of PLUS, the PLUS Foundation Gives Back. The Foundation will continue its tradition of giving back to a local charity in conjunction with the PLUS Conference – this year PLUS members will prepare care packages for deployed troops in support of the USO of Metropolitan Washington-Baltimore. The Foundation will also host a Women’s Leadership Network (WLN) lunch at the PLUS Conference featuring former First Lady Laura Bush, as well as many local WLN events in the coming months. This issue announces the recipients of the Gilmartin and Financial Aid Scholarships. And, soon it will be awarding its first WLN scholarships and releasing a new website.

There are even more exciting areas where PLUS is building momentum – like enhancing the curriculum, offering more webinars, planning for Symposiums, and enhancing volunteer opportunities (See *Time to Raise Your Hand* in this issue) – but since you have about 60 awesome pages ahead of you, I will stop. Enjoy.
As any student of insurance history knows, it can be too soon to study an insurance market. Far more entrepreneurial than outsiders realize, the insurance business regularly develops new products that don’t work out. When one does work out, the mature product may not look much like the lightbulb that went off in the heads of the crazy underwriters who invented it. So, if you study a new insurance product market too early, you’ll get the wrong idea of what it’s about.
When Leib Dodell described to me – at my dinner table in West Hartford over 20 years ago – the Safety’Net product that Chubb was getting ready to launch, I knew immediately that I was in the presence of one of those crazy underwriters. Inside Leib’s lightbulb, Safety’Net was “internet liability insurance,” which meant media liability insurance for all the Main Street businesses that were becoming publishers by virtue of putting up a webpage.

Elsewhere in the universe, Emily Freeman had a different lightbulb at about the same time. Emily and her colleagues at Marsh developed Net Secure, the first “online insurance program,” which meant business interruption insurance for “internet businesses” facing downtime from hacking, fraud, and viruses, with some liability and privacy loss protection as well.

I caught up with Leib recently, by phone from his newest venture, Bar K, an emerging chain of dog park bars (yes, you read that correctly) that make use of distressed space inside city cores. I asked Leib to imagine himself back at the Safety’Net lightbulb moment and then immediately transported to today: What surprises you about the cyber insurance market in 2019? What’s the same today as back then?

Leib said that he was most surprised that the “first party” breach coverage turned out to be more significant for most people than the liability coverage. “That means Emily Freeman was right at the beginning, and I was wrong,” he said. What is the same, he said, maybe even to a surprising extent, is the uncertainty. The risks are still significantly unknown, the policies continue to evolve, and, as a result, pricing continues to involve lots of trial and error.

Leib’s trip back to the future convinced me of two things. First, it’s not too early to study the cyber insurance market. Leib may not have been right at the beginning, but he says that Emily Freeman was. That means there are twenty years of enough continuity that we ought to be able to make sense of what the cyber insurance market does and how it works. Second, there is at least one very big continuity that clearly deserves our attention: How have insurers managed for over twenty years to sell insurance against cyber risks that their underwriters don’t (and can’t) fully understand?

It’s still early in my study, but I have a preliminary answer to that question that I’ve shared with Leib, as well as some cyber insurance professionals who haven’t abandoned insurance in favor of economic development projects. They have encouraged me to share that answer with readers of the PLUS Journal. I encourage you to let me know where I’m right and where I’m wrong, because there is still plenty of time for me to get it right.

My answer comes in five and a half parts. The five are (1) providing valuable services beyond risk transfer, (2) contract design, (3) rapid iteration of pricing and forms, (4) limits management and reinsurance, and (5) claims disputing. The final half is public backstops and pools, which is a half because it hasn’t yet gone beyond the talking phase.

Beyond risk transfer. Most notably to me, cyber insurers manage uncertainty by providing lots of easy-to-price loss prevention and loss mitigation services, so that the value proposition of a cyber policy includes low cost access to high quality services, not just the risk transfer that typically motivates insurance purchase. These services often include risk assessments and intrusion testing, and they almost always include expert assistance in responding to privacy breaches, ransomware attacks, data destruction, and other cyber events. For many if not most policyholders, these services may be the most salient aspects of the coverage.

I include these services as uncertainty management tools for several reasons. First, the tools aim to reduce the frequency and severity of cyber losses, potentially reducing insurers’ losses, especially the crucial area under the right tail of insurers’ loss distribution. Second, to gain access to the post event services, policyholders must report those events to their insurers, with the result that insurers are able to gather more and better data about loss events that they can use in contract design, pricing and underwriting. Finally, these services help insurers build demand for cyber insurance without exposing too much of their balance sheets to the underlying cyber risks.

Contract design. Insurers use contract design to manage cyber uncertainties in both cyber and non-cyber policies. In cyber policies, the key design elements are narrowly defined categories of coverage, typically with separate limits...
for each category, and claims made coverage for liability risks. The narrowly defined categories and limits interact with the rapid iteration of pricing and forms (which I'll describe next) to allow insurers to dip their toes in the water and only gradually go in deeper. The first party risks that provide the bulk of the protection always have a relatively short tail. The claims made coverage for the liability risks gives insurers some comfort that they can get out of the water quickly on the liability side, too.

In non-cyber policies, like traditional property, general liability and errors and omissions policies, the most important cyber risk design element is the exclusion, to manage the “silent cyber” coverage under those policies and shift coverage for cyber risks to cyber policies. There is also an emerging trend, at least in the property insurance market, of a cyber coverage sublimit that, in effect, gives back part of the coverage for cyber risks that would otherwise be excluded, similar to the flood sublimits in many commercial property programs.

Rapid iteration of pricing and forms. One very important way for insurers to manage uncertainty is to pay close attention to the results under their current book of policies and then to regularly and rapidly update policy forms and prices based on that information. Leib says that’s what he did at the beginning, and that’s what I observe insurers doing today. All that updating can drive some people crazy, and it means that the results under old policy forms become increasingly less relevant for future pricing. But that’s a tradeoff that allows insurers to venture into the unknown. Rate and form regulation complicate that rapid iteration, so most or all of the cyber policies are issued in the surplus lines market, which is largely exempt from that regulation.

Updating traditional policies, which are subject to rate and form regulation, is more cumbersome. As a result, fine tuning an insurer’s approach to the silent cyber coverage provided in a traditional policy will take longer than fine tuning a cyber policy. As a corollary, explicit grants of cyber cover will remain largely the province of cyber policies, at least for now, except perhaps in the large commercial market, where regulation is less intrusive because regulators expect brokers and risk managers generally to provide adequate protection for policyholders.

Limits management and reinsurance. For insurers, limits management and reinsurance are two different, but highly complementary strategies for managing uncertainty. Limits management is a complicated topic that perhaps can best be explained by identifying the key moving parts: the amount of the cover provided to any particular customer against any particular set of risks; the amount of cover provided to each customer segment against a set of risks; the amount of cover provided overall against a set of risks; and the relationship of all these things to the other risk and customer segments of the insurer. The most complicated parts of this include assessing the relative risks of different customer sectors and assessing the potential for aggregation (in other words, lots of claims all at the same time) within and across sectors. Reinsurance is a complementary strategy, because reinsurance contracts can be crafted to share or cap the insurer’s exposure on a customer, customer segment, product segment, or company wide basis (and other ways as well).

Reinsurers need their own limits management strategy, too. They need to decide how much cover they’re willing to provide to any particular insurer against any particular set of risks. They need to segment their insurer customers. And they need to track and manage their exposure, not only on an insurer by insurer, segment by segment, and product line by product line basis, but also according to their exposure to specific large policyholder companies (which buy towers of insurance from multiple insurance companies), on both the liability and asset sides of their balance sheet.

Not surprisingly, reinsurers are highly focused on the uncertainties of cyber risks. They and their vendors are building tools to track and model cyber risks. They are engaging with technical experts to understand and assess cyber risk, especially from an aggregation perspective. And, so far at least, they are selling cyber reinsurance only on a quota share basis, meaning that they share a fixed percentage of the reinsured risk with the ceding insurer from the first dollar all the way up to the limit of the reinsurance contract. Reinsurers are not yet willing to sell cyber reinsurance on an excess of loss basis (a form of reinsurance in which the reinsurer pays all or a share of losses after the ceding insurer pays a certain amount) because they are not prepared to reinsure only the (more uncertain) right tail of the loss distribution.
Claims disputing. Almost nobody in the insurance industry likes to talk much about claims disputing. But claims disputing can be an important uncertainty management tool. Claims disputing provides the opportunity for a deeper dive into the circumstances of a big loss than would otherwise generally be the case, generating knowledge that has the potential to inform underwriting and contract design. Claims disputing also clarifies the meaning of insurance policies and, thus, the boundary of the risk transfer. This has been especially important for silent cyber risks, and the current litigation regarding war exclusions in cyber policies suggests that claim disputing will help define the boundaries of the risk transfer under cyber policies as well.

Public sector backstops and pools. The litigation over the application of the war exclusion points to my final category: public backstops and pools. The concern underlying the war exclusion litigation is that state-sponsored or state-encouraged cyber attacks differ from ordinary cyber attacks in at least two important ways.

First, ordinary cyber events are more like ordinary crime and negligence and, typically, are not intended to destroy the businesses affected. Where the perpetrator acts with intention, the object typically is theft or ransom. Where the object is theft, the perpetrator tries hard not to disrupt the business; where the object is ransom, the perpetrator needs to provide credible evidence that the disruption can be undone, or the business will not pay the ransom. By contrast, state sponsored or encouraged cyber attacks are more like terrorism: destruction is the object, greatly increasing the business interruption and system and data restoration loss.

Second, state sponsored or encouraged cyber attacks are more likely to be directed to cause maximum destruction, shutting down essential services, or replicating on a massive scale. This raises concerns about loss aggregation, which, as we learned from the impact of the terrorist attack of 9/11 on life and workers compensation insurers, can affect insurers in unforeseen ways.

These differences suggest that there may be a role for the public sector in arranging financial backstops or pools for at least some cyber risks. While it’s too early to identify the precise justification for this kind of arrangement, candidates include the destructive impact of a massively aggregated loss on insurer capital, the fairness of using public funds for projects that benefit society as a whole, the social security provided by having a backstop in place, and the potential consideration that the insurance industry could be asked to provide in return for these arrangements, such as cyber event data and cooperation in disseminating best practices.

End Notes


ABOUT THE AUTHOR

TOM BAKER

Tom Baker is a law and business professor at the University of Pennsylvania and a longtime academic member of PLUS. He is co-author, with Sean Griffith, of the leading academic press book on D&O insurance: Ensuring Corporate Misconduct (U. Chicago P. 2010), the author of The Medical Malpractice Myth (U. Chicago P. 2005), and the author or co-author of many research articles on topics of interest to PLUS members, such as lawyers professional liability insurance, medical liability insurance, and the impact of insurance of personal injury litigation. Currently he is researching cyber insurance and the insurance runoff market.
We are a specialist insurer with over three decades of experience in providing clients with the highest standards of underwriting and claims service.

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The increasing diversity and inclusion (D&I) efforts in the professional liability industry are vital to PLUS members, supporters and advocates. PLUS itself has dedicated programs and initiatives to grow, support and advocate for the continued progression of diversity and inclusion within the professional liability insurance industry.

DIVERSITY & INCLUSION AT PLUS

PLUS endeavors to create an inclusive environment and atmosphere open to differences, where each individual has opportunities for professional development. There are currently two key efforts in place by PLUS volunteers to support D&I goals: The Diversity & Inclusion Committee and the Diversity Leadership and Mentorship Program (LAMP).

PLUS’ Diversity & Inclusion Committee
The PLUS Diversity & Inclusion Committee helps to create an inclusive, welcoming environment within PLUS and lead PLUS to engage the professional liability industry by being an inclusive global community, providing opportunities for career development, networking, and advancement for all members and participants. Committee members reflect a variety of backgrounds, races, cultures, traits, ethnicities, genders, sexual orientations, ages, physical abilities, family structures and perspectives.

PLUS’ Diversity Leadership and Mentoring Program (LAMP)
LAMP is a one-year leadership development training program for PLUS members from diverse and traditionally under-represented groups within the professional liability insurance industry. The curriculum focuses on leadership coaching and includes matching participants with senior-level PLUS members who have agreed to serve as mentors throughout the program.

Over the years, PLUS has had many strong advocates and dedicated members who have continued to encourage diversity and inclusion mission in many ways. We talked to four of these members to discuss their thoughts, experiences, and history with PLUS and D&I efforts in their organizations.
Deborah has been in the professional liability industry for more than thirty years. She passionately believes in PLUS and how the association helps the industry, and also believes in the diversity and inclusion programs she has helped lead in more recent years.

She started her career at AIG, then moved to Travelers Insurance and is currently with US Risk. During her career, she has taken her commitment to PLUS seriously; participating on committees, networking and helping others to be involved in PLUS.

Early on at PLUS, Deborah felt that it was important to bring some of the excellent educational and networking events that PLUS developed to a smaller, regional scale. She helped chapters and the leadership to create their own programs under the PLUS brand. Additionally, she worked to develop Women’s Leadership Network events, featuring more diverse speakers and topics, as a member of the PLUS Foundation Board. Deborah’s networking skills and capabilities grew as her involvement in PLUS expanded and both have become a part of her personal brand.

As the chair of the PLUS D&I Committee, Deborah has committed to utilizing her networking skills to help secure more diverse presenters at PLUS events such as Julio Portalatin, Vice Chair at Marsh & McLennan Companies, who will speak about the intersection of diversity and automation at the upcoming 2019 PLUS Conference.

Deborah notes that her success within the professional liability insurance industry is in part due to her committee and networking work within PLUS. She is recognized as a leader, an advocate for diversity and a champion for the inclusion of all. Deborah stated “I’m excited to take charge and to be a part of the D&I Committee. I see us as innovators and collaborators, and our goals are really to educate, to empower and to elevate.”

Deborah’s past and continued involvement with PLUS is a great benefit to the entire member association. She takes her roles seriously and strives to lead change and diversity.
La’Vonda started out at Zurich North America for the first four years of her career working with underwriting, claims and risk engineering. She followed up that experience with a law degree from Howard University and practiced labor and employment law at Freeman Mathis & Gary. After two years, she was recruited back into the insurance industry in 2014 at Willis Towers Watson where she serves as the healthcare industry and segmentation leader for North America.

La’Vonda was first introduced to PLUS while at Zurich, but became more engaged in 2014 through membership, attending the PLUS Conference and earning CE credits. She admitted she wasn’t always sure of the best way to get involved in PLUS, but when she saw the introduction of the Leadership and Mentoring Program (LAMP) that emphasized mentoring and furthering the careers of those from diverse and traditionally underrepresented groups within the insurance industry, she wanted to be a part of it. She applied for the program and participated in the first LAMP cohort in 2016.

“One of the goals for LAMP is to make sure that participants stay engaged and involved in PLUS after the program. When the opportunity presented itself to join the Diversity and Inclusion Committee, I expressed interest because I really wanted to continue my engagement with PLUS,” stated La’Vonda in regards to the progression of her volunteer efforts with PLUS.

Not only does La’Vonda take part in PLUS D&I activities and programs, but she’s also a strong advocate at Willis Towers Watson. As the East co-lead of the Multicultural Inclusion Network, La’Vonda coordinates with different offices in the region to plan programs and facilitate conversations about inclusion within Willis Towers Watson. The network celebrates the value of diverse backgrounds and enables D&I education within the organization. They’ve provided forums such as a panel discussion on gender issues in the workplace and unconscious bias training for people managers, in addition to social events and activities for participants.

Although Willis Towers Watson and other organizations within the professional liability insurance industry are developing and executing platforms for D&I dialogue, La’Vonda noted that the industry as a whole still has a way to go. She felt that although women are slowly becoming more prevalent in executive level and management positions, minorities in the industry, especially in executive level positions, are still limited. This is why programs like LAMP and the execution of D&I initiatives are so important.
Assistant Vice President – EPL Claims
Practice Leader
QBE North America

Member Since: 2017

MOIRÉ MORÓN, ESQ.

PLUS COMMITTEES & INVOLVEMENT:
Second LAMP Cohort
Diversity & Inclusion Committee
LAMP Mentor

Moiré was raised on St. Thomas in the United States Virgin Islands. After completing her education, and having worked in a number of industries, Moiré decided on a career in the professional liability insurance industry. She began at AIG as an Analyst working with D&O and EPL for seven years. In 2014, she moved to QBE where she works with active claim practices for the D&O and EPL group and is now the Claims Practice Leader for the Employment Practices Liability claim group.

Moiré was first introduced to PLUS through QBE’s active participation in conferences, which allowed her to become more actively involved. “I think it’s an amazing organization. Nine times out of ten, people’s interaction and involvement seem to be limited to going to the Conferences. I think they’re missing a lot of what’s actually offered,” stated Moiré.

Moiré participated in the second LAMP cohort and has also transitioned to the PLUS D&I Committee. Moiré commented that her involvement in LAMP, which also includes serving as a mentor for the third cohort, has positively impacted her career, helping her better network and navigate opportunities and challenges within professional liability.

Not only does Moiré work with PLUS’ diversity and inclusion initiatives, but she also works hard to develop, grow and celebrate diversity programs within QBE as well. Although there was a LGBTQ Pride Business Resource Group at QBE, it was largely dormant. Moiré got involved and helped to revitalize the group by increasing numbers, expanding to two additional offices, and volunteering within the community. They even collaborate externally with some of their business partners like Aon.

After moving to Atlanta, Moiré also helped revitalize the LGBTQ Pride BRG there as well. They volunteered with programs like ‘Backpacks in the Park’ where they put together backpacks of back to school supplies for less fortunate students, as well as Habitat for Humanity volunteer efforts. Moiré also expressed a passion towards helping youth navigate the LGBTQ stigma as well. Impressively, she plans to continue her volunteer efforts towards disabled employees and developing strong corporate programs for them as well.

When asked how the professional liability industry has evolved regarding diversity and inclusion practices, Moiré noted that organizations are finally realizing that their employees and applicants are no longer homogenous. They have different backgrounds, histories, experiences, cultures, ages, genders, and the blend of all these variations are a positive influence within the industry. Companies that are reluctant to make diversity a priority will be left behind.
Chester has been with Aon for the past 15 years where he currently holds the position of Vice President and Director within the Professional Services team at the organization. He deals with malpractice insurance for mid-sized law firms across the US. In addition to Aon, he has also been involved in PLUS in a variety of capacities. He completed the Registered Professional Liability Underwriter (RPLU) Program in 2009 and was one of the first Future PLUS members. Future PLUS members are 35 years old or younger and receive additional discounts and programs targeted towards career growth and business development.

In 2014, Chester joined the newly formed PLUS Diversity & Inclusion Committee and served as the first chair. As a part of the D&I Committee, he participated in developing programs like LAMP and working with regional chapter leadership to bring diversity into local events. His term ended in 2018, but that hasn’t slowed his efforts to promote diversity and inclusion in the workplace.

Chester is also the chair of the Aon Pride BRG in New York and helped create a national Pride Diversity Council. In this role he works with members from Chicago, San Francisco, Atlanta and other regions to broaden Aon’s Pride BRGs across the US. Another diversity group on which Chester participates is the Aon New York Diversity Council. This brings together chairs of other local groups to facilitate conversations, events, education and other items just for the New York region.

When asked, Chester noted that the insurance industry has changed quite a bit in the past 10-15 years. “I think that people in insurance are not shying away from the tough discussions anymore. They are more bluntly saying ‘diversity is important’.” He continues to drive diversity programs and initiatives within Aon and PLUS.
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Women’s Leadership Network and PLUS Foundation Luncheon Featuring Keynote Speaker Laura Bush

Mrs. Bush is an advocate for literacy, education and human rights. During her keynote address, Mrs. Bush will discuss her time as First Lady of the United States, her reflections on 9/11, her passion for education and the work of the George W. Bush Institute.

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CONFERENCE.PLUSWEB.ORG
DIGITAL CURRENCY
AND ITS POSSIBLE FUTURE IN SECURITIES LITIGATION

BY: JOEL WERTMAN

Let’s start simple, or at least as simple as can be expected for a discussion on potential litigation related to money that for the most part you can’t actually hold in your hand like a coin or bill. Virtual currencies are electronic money that some people will agree to accept and treat just like other forms of money. However, virtual currency has distinct differences from traditional currency such as the dollar. First and foremost, no virtual currency is issued or backed by the United States nor is anyone required to exchange them or accept them as payment. Indeed, the whole framework basically depends on a public ledger called the blockchain, digital wallets and a worldwide network of private computers mining information. (If that last sentence sounds confusing, well, hang in there.)
There are over 1,600 different digital currencies but the most well-known for general illustrative purposes is Bitcoin. In guidance published in early 2017, the Financial Industry Regulatory Authority (FINRA) provided a useful primer which attempted to demystify the digital currency and its related terminology. As a starter, FINRA explains that Bitcoin is a cryptocurrency. In other words, it is a digital currency secured by codes that can’t be read without a key. The amount of Bitcoin in circulation is determined by an algorithm developed by its founder which determines how many Bitcoins are produced and added to the economy every year through Blockchain technology. Basically, it’s a ledger of all Bitcoin transactions that anyone can download but is immutable. “You can only add to it, you can’t edit it,” explained Dr. Campbell Harvey of Duke University. (There are many technical reasons why that is so, but a discussion of cryptographic links is best reserved for a different author.)

Bitcoins are created by a process called mining which is very labor intensive. However, instead of using hardhats and going down into a mine, Bitcoin miners use software algorithms to add transaction records to the public ledger of past transactions and verify legitimate transactions where Bitcoins are traded or spent. For those efforts, miners receive transactions fees. In addition, if you find a new “block,” the miner is awarded bitcoins. (In an oversimplified way, think of a “block” as the distinguishing digital information about a verified transaction which is stored in a public database called the “chain.”) Adding to the potential desirability, only a finite number of bitcoins can be mined; 21 million based on the complex mathematics underlying Bitcoin mining.

As most people don’t have a PhD level understanding of computer cryptography, there are other options than mining to obtain a virtual currency like Bitcoin. Crypto exchanges work similarly to a stock exchange. An exchange would act as a matchmaker and charge a fee for completed transactions. At present, only a handful of broker dealers have secured approvals to list digital assets and conduct some initial security token transactions. The firm operations section on BrokerCheck for these entities will typically describe the type of business as, “alternative trading system for secondary trading of private and unregistered securities, involving digital assets and securities” or similar such disclosure language. At present, there are supposedly as many as 40 pending applications with FINRA, so the landscape is certainly evolving.

With that evolution will certainly come increased litigation both from securities regulators and public customers. FINRA has repeatedly described virtual currency as volatile, risky, speculative and subject to hacking. The storm warnings are on the horizon. It’s certainly easy to envision crypto currency fitting into the commonplace theories of liability in securities arbitrations such as suitability, selling away, Ponzi schemes and fraud. Indeed, recent regulatory actions and guidance have offered a potential framework for such claims by public customers.

A particular instructive example comes from New Jersey where the State recently filed a three-count lawsuit against a blockchain-driven online rental marketplace, and its president. The lawsuit alleges that Defendants offered and sold $410,000 of unregistered securities in the form of a cryptocurrency to 217 investors. The offering was advertised as a way to raise capital to develop an online marketplace using blockchain technology, where consumers would be able to use and spend tokens made available through an Initial Token Offering (ITO). The Defendant is a travel website which linked to the ITO website which advertised that the company was developing an “online community driven marketplace ecosystem [where users would be able to exchange goods and services], built around a decentralized blockchain oriented model.” The website further included a link to a private placement memorandum which included a description of the business and tokens. In particular, investor funds were to be used for development and engineering with the tokens to be used for various transactions on the company ecosystem that was under construction.

The tokens were sold pursuant to an exemption from registration that requires all purchasers to be verified as accredited investors. It is alleged that Defendants failed to take reasonable steps to comply with the requirement to ensure that the investors were accredited. The company merely required investors to confirm their accredited status by checking a box during the online investment process. The website requested “income proof documents” but allegedly only 11 of the 217 investors actually provided them. Thus, the vast bulk of investors were approved allegedly without proper vetting of their accredited status. The matter is ongoing.
The SEC undertook recent administrative proceedings which are further instructive. In the Matter of Paragon Coin, SEC administrative proceeding 3-18897, an Order was issued on November 16, 2018 imposing penalties and a cease and desist order. Paragon is an online entity that was purportedly established to implement blockchain technology in the cannabis industry. It sold digital coins issued on a blockchain but did not register the offering nor attempt to qualify for a registration exemption. Digital tokens were sold to the general public via private agreements. A monetary sanction of $250,000 was imposed among other remedial measures.

The SEC also issued an Investor Alert cautioning about Ponzi schemes using virtual currency. The SEC’s well-founded concerns are that fraudsters would entice investors into Ponzi schemes in which these currencies are used to facilitate fabricated investments or transactions. Like most Ponzi schemes, the promise of high returns for “getting in on the ground floor” remains a concern as well as the hallmarks of fraudulent Ponzi schemes such as overly consistent returns, unregistered investments, complex strategies and fee structures, and no minimum investor qualifications.

In fact, the SEC has obtained a $40 million judgment against the operator of a Bitcoin Ponzi scheme. In SEC v. Shavers, a federal district court entered final judgment against an online entity created and used to operate a Ponzi scheme through which investors were defrauded out of at least 764,000 bitcoins which, at the time, were worth more than $4.5 million. The defendant solicited investors in online chat rooms and an online forum dedicated to Bitcoin. The defendant promised returns of 7% per week (!) based on trading Bitcoin against the U.S. Dollar. He actually just used the new bitcoin received from investors to pay supposed returns and his personal use. This matter also resulted in the first U.S. criminal securities fraud case related to digital currency as the perpetrator was sentenced to 1 ½ years in prison.

Also of concern is that digital currency is potentially at greater risk for being stolen. Mt. Gox was a bitcoin exchange based out of Japan that, at its height, handled roughly 70% of all bitcoin transactions in the world. Bizarrely, the exchange website initially started as a place for fans of the card game “Magic: The Gathering” to trade cards online before morphing into a bitcoin exchange. In early 2014, it suspended trading and filed for bankruptcy protection. It later announced that approximately 850,000 bitcoins belonging to its customers were missing and probably stolen. That represented roughly 6% of all bitcoins in circulation! A significant portion of the bitcoins were eventually found, but ultimately hundreds of thousands of customer bitcoins were stolen directly from Mt. Gox.

This is merely a starting point for understanding where potential litigation could be headed. In ten years, litigation surrounding digital currency may become commonplace. Indeed, recent regulatory events suggest that it may just be a variation on existing risk management and best practice concerns. However, the backdrop of that history is being written now and may, like evolving technology tends to do, take us to places that we can’t now imagine. It’s a brave new world.

ABOUT THE AUTHOR

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Diversity and inclusion have been on the minds of executives and employees alike for decades. As workplace cultures continue to shift and businesses become more global, diversity isn’t just a trending topic—it’s a lasting influence. But diversity on its own is not enough. Research from experts at academic institutions across the country show that diversity, when supported with an inclusive environment, enriches the workplace by engaging with different perspectives, utilizing existing talent, and reducing workplace harassment and discrimination issues. This research also illustrates how supporting diversity with inclusion is essential to seeing the benefits of diverse perspectives and increasing both productivity and performance.
Research on the Advantage of Different Perspectives

Innovation is a driving factor for all industries, including the insurance industry, and keeping up with the current marketplace and predicting what will come next is crucial to a company’s success. One major benefit that is found with a diverse workplace is the ability to hear and use different perspectives to drive and sustain innovation. The Center for Talent Innovation researched the effect of a diverse workforce on business innovation and found that:

“[A]n inherently diverse workforce can be a potent source of innovation, as diverse individuals are better attuned to the unmet needs of consumers or clients like themselves. Indeed, their insight is critical to identifying and addressing new market opportunities. We find that when teams have one or more members who represent the gender, ethnicity, culture, generation, or sexual orientation of the team’s target end user, the entire team is far more likely (as much as 158% more likely) to understand that target, increasing their likelihood of innovating effectively for that end user” (Hewlett et al., 2013).

With this knowledge, the CTI postulates that the more diverse a workplace is the better, as more perspectives make for more market opportunities with a much higher chance of success. The multitude of perspectives that a diverse workplace provides is most useful when supported with an inclusive work environment. When employees know that their voices are heard and valued, they are more likely to speak up and present their ideas. More ideas lead to innovation with practical and effective application in the marketplace.

The advantage of different perspectives is especially crucial when companies are appointing people to board positions. For their article “When and Why Diversity Improves Your Board’s Performance,” Stephanie J. Creary, assistant professor of management at the Wharton School of the University of Pennsylvania, and her colleagues interviewed nineteen board directors across the U.S. who collectively held seats on forty-seven corporate boards. Their research showed that a wide range of diversity is important to board performance: not just gender, but also factors such as race, age, and nationality, as well as professional diversity in the experiences and career paths of board members. Their research also found that an inclusive and supportive board culture is essential to increasing board performance. It isn’t enough for a board to have a diverse array of perspectives—the board also needs to practice inclusion with a culture that invites different ideas and perspectives, and values the people that put these ideas and perspectives forward.

Companies are paying attention to this, as Creary explains that “many boards are also broadening the range of professional backgrounds considered for board member positions, allowing them to attract more socially diverse directors who bring, as one interviewee referred to it, ‘diversity of thought.’” (Creary et al., 2019). When boards fill seats with only people that they already know, the entire company suffers from a lack of “diversity of thought.” Reaching out and assembling a more diverse board can positively impact performance when that board also creates an environment where ideas can not only be heard but improved upon and enacted. This type of environment is important not only at the board level but throughout the workplace. An inclusive environment allows diversity of thought to permeate the company culture and bring more ideas to the surface as well as drive in the application of these ideas.

Research on Utilizing Existing Talent

Companies are constantly searching for the best talent to add to their workforce. But for many companies, the talent that they’re searching for is already there. Alexis Nicole Smith, assistant professor of Management at Oklahoma State University, and her colleagues interviewed 59 black female executives and found that in many cases, these women were overlooked for positions in which they would excel. “For example, one woman said, ‘I’m the best choice for this job, and I’m probably not on your radar screen.’” (Smith et al., 2018). For companies that are already working towards diversity, this is where inclusion is crucial. A benefit of an inclusive workplace is that voices like these don’t go unheard. Smith’s research shows that when black women are put in positions of power, “they chose to be authentic leaders and share their experiences with others” (Smith et al., 2018). Diversity in leadership can help bring other diverse voices and perspectives to light, increasing inclusion in teams and in the workplace as a whole, and utilizing existing talent that may have gone overlooked. Research from the Center for Talent Innovation shows that diverse leaders “are significantly more likely to behave inclusively,” and help to foster an inclusive environment where diversity can thrive (Hewlett et al., 2013).
In a different study, Cassandra Guarino, Professor of Education and Public Policy at the University of California Riverside, and Victor Borden, Professor of Higher Education and Student Affairs at Indiana University Bloomington, researched who does “office housework” as opposed to “glamor work.” Glamor work consists of assignments that often lead to promotions or new opportunities, while office housework is essential but often tedious duties such as administrative work, organizational work, and emotional labor. Guarino and Borden found that women do significantly more office housework than their male colleagues, even when they hold equal positions (Guarino and Borden, 2017). This results in these women having less time for the glamor work that will get them noticed, and their talents are left untapped. Encouraging diversity allows leadership to recognize this disparity and correct it, giving employees a chance to show their perspective on a particular project and display their talents. In an inclusive work environment, these employees feel more comfortable voicing their ideas and may speak up when the share of glamor work and office housework is unequal.

Another way companies can utilize existing talent is by scrutinizing their layoff process. Alexandra Kalev, an associate professor at Tel Aviv University, did a study which found that companies often undercut their diversity efforts when laying off employees. Her study found when companies cut entire positions, or lay off employees who were most recently hired, there is up to a 22% drop in the number of minorities in management. However, Kalev also found that “companies that lay off managers with the poorest performance see no reductions in diversity. This individualized approach has the added benefit of keeping strong performers regardless of what positions they currently hold or how long they’ve been with the firm” (Kalev, 2016). Taking a look into the layoff and hiring process can shed light on where diversity programs are failing or succeeding, and adjusting these processes can benefit a company looking to increase productivity and performance. Rather than laying off employees before they can contribute their ideas or simply because of their job title, performance-based cuts let employees feel that they are valued for their work and the workplace benefits as a result. Moving employees around within the company has also shown to be beneficial, providing different people with new opportunities and experiences that can be informed by their unique perspectives. Kalev points out that “looking at the numbers reminds executives that they can use tools such as repositioning and retraining to maintain managerial diversity after they’ve made performance-based cuts. And it gets them thinking more creatively about the talent they have — and want to keep” (Kalev, 2016).

From Inclusion to Innovation

Workplace harassment and discrimination are all too prevalent in the business world. With a diverse workplace, however, these issues arise much less often. Alexandra Kalev and her colleague Frank Dobbin, a professor of sociology at Harvard University, found that “in industries and workplaces where women are well represented in the core jobs, harassment is significantly less likely to occur.” (Dobbins and Kalev, 2017). Their research reflects similar results to that of Smith and her colleagues, mentioned previously; when diverse voices are in leadership positions, more talent and ideas are available. In an inclusive work environment, aided by diverse leadership, employees feel safer and are not only more willing to share their ideas, but are able to engage with their peers openly and successfully.

Reducing workplace harassment is a step towards inclusiveness, which many studies have shown to dramatically increase performance and productivity. Juliet Bourke and Andrea Espedido, partner and consultant in Human Capital, respectively, did research on inclusive workplaces and found that “[inclusiveness] directly enhances performance. Teams with inclusive leaders are 17% more likely to report that they are high performing, 20% more likely to say they make high-quality decisions, and 29% more likely to report behaving collaboratively” (Bourke and Espedido, 2019). Supporting a corporate culture where diversity is valued increases inclusiveness and, in return, raises performance and productivity.

More and more companies are working within and outside their own organizations to improve diversity and increase inclusion, and studies support their efforts. Research consistently shows that a company with a diverse and inclusive workplace will reap the benefits of unique perspectives on new marketplaces, existing talent within the company structure, and better management of harassment and discrimination incidents. A more inclusive workplace culture fosters diverse talent and leads to better performance for the industry overall.
End Notes

Center for Talent Innovation
https://www.talentinnovation.org/_private/assets/IDMG-ExecSummFINAL-CTI.pdf
https://www.talentinnovation.org/_private/assets/IDMG_PressRelease-CTI.pdf

When and Why Diversity Improves Your Board’s Performance

Interviews with 59 Black Female Executives Explore Intersectional Invisibility and Strategies to Overcome It

For Women and Minorities to Get Ahead, Managers Must Assign Work Fairly

When Good Deeds Go Unpublished: Study led by UCR researcher shows women faculty take on more internal service work than their male colleagues
https://ucrtoday.ucr.edu/46071

Faculty Service Loads and Gender: Are Women Taking Care of the Academic Family?

How “Neutral” Layoffs disproportionately affect women and minorities

Training Programs and Reporting Systems Won’t End Sexual Harassment. Promoting More Women Will

Why Inclusive Leaders Are Good for Organizations, and How to Become One
https://hbr.org/2019/03/why-inclusive-leaders-are-good-for-organizations-and-how-to-become-one

The diversity and inclusion revolution: Eight powerful truths

Waiter, is that inclusion in my soup? A new recipe to improve business performance
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As long as businesses continue to collect and process private consumer information, the threat of sensitive data compromise will exist. In the absence of comprehensive federal data breach legislation, individual states are filling that void and attempting to reshape data breach and privacy laws to increase protection of consumer data. A number of factors are motivating the states’ legislative efforts. First, the current laws are primarily focused on post-data breach notifications and privacy protections. However, consumers are notified so frequently of a potential compromise of their information that the threats have become more annoying than frightening. Further, a notification does not change the fact that their information was compromised, and the damage has potentially already been done. Second, the European General Data Protection Regulation (“GDPR”), which more strictly enforces consumer privacy protections through governmental agency fines, may be providing an example for some states. Third, concern about data privacy is becoming increasingly personal with biometric data compromise (fingerprints, retinal scan, facial features) being recognized as an emerging threat to consumers, being something that cannot be changed as easily as a credit card number, highlighting the importance of putting protections in place to prevent a breach in the first instance.
Several individual US states are changing or proposing changes to their laws to deal with the above concerns. So far, they have taken two varying approaches. The first is the “stick” approach, trending in the direction of strict consumer protections and stronger regulatory powers similar to those found under the GDPR. The second is the “carrot” approach, incentivizing businesses to protect consumer information before a breach happens by rewarding heightened security standards as opposed to simply imposing damages after a breach. We will explore the laws of a few states in more detail below and then provide some practical observations for claims, underwriting and risk management professionals. Finally, we offer some thoughts on why the ultimate goal of data breach and privacy regulations should be to incentivize businesses to protect consumer data, mitigate the risk of data breaches by focusing on root causes, and keep interests of businesses and their customers aligned by avoiding costly litigation and oppressive statutorily created damages.

**CALIFORNIA**

California, the first state to pass a data breach notification law in 2003, is moving closer to the sweeping breadth of the GDPR with the passage of the California Consumer Privacy Act (“CCPA”) in June 2018 (to go into effect on January 1, 2020). The CCPA will expand the rights of California residents to control the disclosure of their personal data and increase the burden on businesses to manage retention of personal information. Businesses will fall under the purview of the CCPA if they are associated with the collection and processing of personal information and either have revenues of $25,000,000 annually, collect, buy or sell the info of 50,000 California residents annually, or derive 50% or more of their annual revenues from the sale of personal information.¹

The CCPA will broaden the definition of personal information to include any information that “identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household,” including names, social security numbers, passport numbers, financial information like insurance policy numbers, IP addresses, geolocation information and health and medical information, as well as biometric information.²

Consumers will be granted broad rights with respect to the handling of their personal information including: the right to opt-out of the sale of their information (with opt-in requirements with affirmative authorization for minors); request disclosure of the types and categories of information collected and sold by the business including the sources from which it is collected; the right to request deletion of personal information; and the right to be free from discrimination for exercising rights under the statute.

The California Attorney General has enforcement powers and may bring actions for violations of the CCPA. Consumers will have a private right of action for the unauthorized acquisition of non-encrypted or unredacted personal information and will be entitled to the greater of actual damages or statutory damages of $100 to $750 per violation. Enforcement actions by the Attorney General and consumer private actions will both require notice to the business of non-compliance and then a 30-day period to cure.

Despite the strength of the CCPA’s consumer protections, some interest groups believe the CCPA does not go far enough in protecting consumer information. Proposed amendment AB 1760, introduced by Assembly Member Buffy Wicks (D-Oakland) on April 4, 2019, sought to “revise and recast” the CCPA and move California even closer to the strict protections of the GDPR.³ Named the Privacy for All Act of 2019 (“PAA”), AB 1760 sought to grant consumers express opt-in consent rights as a condition to use of personal information. The amendment would have allowed for a private right of action for any violation of the CCPA, as well as removing the 30-day cure period as a pre-condition to suit and allowing the right to recover attorney fees. Consumers would have been granted expanded rights to deletion of personal information as well as disclosure, as businesses would be required to disclose the specific information collected, as opposed to the categories of information.⁴ While the measure was effectively killed when it was pulled from consideration by the California Assembly Committee on Privacy and Consumer Protection, the backing of the amendment by a broad coalition of consumer privacy interest groups (ACLU, Electronic Frontier Foundation, etc.) evinces an appetite in the consumer privacy community to move closed to a GDPR-level of protection.
Massachusetts

Massachusetts’ data breach notification law, the “Standards for The Protection of Personal Information of Residents of the Commonwealth (‘Standards’),” was recently updated and in effect as of April 11, 2019, strengthening consumer protections with respect to data breach notification obligations and disclosure of the extent and purposes of data collection and disclosure to Massachusetts residents.5

Entities subject to the updated Standards must develop a Written Information Security Program (“WISP”) which memorializes, in writing, the systems and processes the company has in place to protect consumer information. The WISP must document polices and procedure for the storage, access and transportation or disclosure of information, as well as documenting a company's efforts taken in response to a data breach incident. Entities that suffer a data breach exposing the Personally Identifiable Information (“PII”) of Massachusetts residents must notify the Massachusetts Attorney General and Director of Consumer Affairs and Business Regulation and show whether a WISP was in place before the breach as well as whether it was updated after the breach.6

Under the new Standards, companies must disclose to residents that there is no charge to consumers to freeze or secure credit in the event of a breach.7 Consumers will be entitled to 18 months of credit monitoring services in a breach where social security numbers (“SSN”) are exposed and 42 months in the event of a credit rating agency breach. Businesses are required to disclosure the categories of PII to be collected and the third parties to which that PII might be disclosed as well as the business purposes for the collection and disclosure of the PII.

Massachusetts seeks to significantly expand consumer privacy protections by expressly designating biometric information as a category of PII with proposed Consumer Privacy bill SB 120, which resembles the CCPA in its breadth of consumer privacy protections.8 Consumers would have a private right of action for a violation of the proposed law and would be entitled to statutory damages of $750 per violation or actual damages, whichever is greater.9 Statutory damages would be subject to the court’s application of several factors to make the statutory damages award more considered and equitable. The proposed law is clear that a simple violation of the statute would constitute an injury in fact, which should prevent the motion practice on standing that the courts have seen under the Illinois Biometric Information Privacy Act (“BIPA”).10 In contrast to the BIPA and CCPA, the proposed law allows a carve-out for biometric information collected by an entity acting in the capacity as an employer.

Washington, D.C. and Vermont

The Washington D.C. Attorney General proposed new data breach legislation titled the Security Breach Protection Amendment Act of 2019 (“SBPA”), which seeks to modernize the District’s data breach protections and move closer to the reach of laws like the GDPR.11 The SBPA would expand the categories of protected information to include biometric information (including DNA profiles), passport numbers, taxpayer identification numbers, military ID numbers, health information, and health insurance information; mandate two years of credit monitoring in breaches where social security numbers are compromised; and require disclosure of consumer rights to credit freeze at no cost.12 Vermont became the first state in the nation to regulate data brokers, requiring companies that buy and/or sell information to register with the state, disclose data collection categories and uses to the public, and comply with various other data protection standards.13,14 Yet, despite the Vermont legislature’s intentions with this effort, it has proven difficult to execute regulation of these businesses, as many companies register erroneously or not at all.15

Ohio and the Carrot

In contrast to the “Stick” approach of the GDPR and its imitators, the Ohio legislature took more of a “Carrot” approach with the passage of the Ohio Data Protection Act (“OH Act”), which was signed into law in August 2018. The OH Act incentivizes the proactive protection of consumer information by offering a safe harbor to businesses that have suffered a data breach by allowing them to take advantage of a legal affirmative defense in data breach litigations if those businesses had a written cybersecurity program in place that reasonably conforms to industry standards.16 The program must protect the security and confidentiality of information and protect against threats that could lead to the compromise of that information, weighed against factors such as the size and revenue of the business and the nature of its activities and
the information collected. Examples of industry standard cyber security programs include: The National Institute of Standards and Technology (NIST) Framework for Improving Critical Infrastructure Cybersecurity; NIST Special Publication 800-171; NIST Special Publications 800-53 and 800-53a; the Federal Risk and Authorization Management Program (FedRAMP) Security Assessment Framework; or the Center for Internet Security (CIS) Critical Security Controls for Effective Cyber Defense. The OH approach shifts the focus from penalties after the fact to persuading businesses to make sure their data protection practices meet industry standards to minimize the risk of data compromise in the first place.

INSURER PRACTICE CONSIDERATIONS

Cyber insurers can prepare for the legislative changes by remaining flexible when underwriting risk and managing claims. For states using the “Stick” approach, carriers can continue to offer robust pre-breach services such as security consulting and extra threat monitoring where appropriate to prevent data breaches in the first place. Carriers offering these value-add services will be more attractive partners for their customers and also make their insureds a better risk. Carriers can also vet new insureds or renewals based on their compliance with the new legal landscape. When underwriting business in states using the “Carrot” approach, carriers can examine an applicant’s written security protocols to determine the state of the Insured’s data protection environment and how well that Insured might mitigate litigation risk after a breach. Finally, carriers must determine how meeting those legal standards affects insurability or price of risk.

From a claims perspective, it is critical to have the appropriate legal and forensic vendors in place to deal with the ever-changing data breach and privacy legal landscape. Cultivation of a nationwide panel of legal professionals with the geographic breadth and expertise to stay current with new state legislative changes in the privacy sphere is key. Cyber claims professionals are in the unique position to vet and develop legal and forensic breach response professionals with the right experience and abilities who stay abreast of the various legislative changes to ensure the execution of the appropriate data breach response.

Finally, while it is clear there is a need for smarter if not stronger laws, we think the ultimate goal of the state data protection laws should be to incentivize the protection of consumer information. Time will tell whether the “Stick” approach will provide that incentive or whether allowing consumers to pursue a private right of action will simply create another niche litigation market that rewards the plaintiffs’ bar with high attorney fee awards, rather than compensating consumers. The proverbial “Gotcha” class action lawsuit with high statutory damages is the same approach rolled out with the Telephone Consumer Protection Act (TCPA), Fair Claims Reporting Act (FCRA) and Fair and Accurate Credit Transactions Act (FACTA); Similarly biometric data litigation under Illinois’ BIPA statute is gaining traction. The high statutory damages contained within these Acts often result in large class action settlements that have, in the past, lead to insurance carriers amending their forms to preclude coverage for these actions as the risk and exposure become too great. In the absence of a single federal data breach and privacy standard, a more reasonable approach for state legislation is to incentivize the proactive protection of private information with safe harbor/affirmative defense provisions based on the most robust system protections (i.e., the Ohio Legislation) as opposed to sparking a costly race to the top on strong data breach fines and statutory damages after an event has already occurred.

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End Notes

1 https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB375 1798.140 (c)
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19 47 U.S.C §227, awards damages of $500 or actual damages, whichever is greater, or $1500 for willful violations.
20 15 U.S.C. §1681, awards actual damages, statutory damages from $100 to $1000 per violation, and potential punitive damages.
21 15 U.S.C. §1681n. Allows for damages of $100 to $1000 per violation
Indemnity, through the use of insurance, has a long pedigree that goes well back in time. However, insurance as we know it today did not really start until the end of the 17th century. It was at that point that insurance companies started to be formed to combat one of the oldest enemies of civilization: untamed fire. Moreover, fire insurance companies understood their enemy well and worked swiftly to combat it; those efforts ultimately gave rise to our present day in which millions of people around the world live largely free from the threat of a fire destroying a neighborhood or city. It is that pedigree which sired all the forms of insurance that we know today whether it be general liability or cyber liability. However, the landscape, as it relates to cyber liability and technology E&O, does not show the responsible insurance traits that such thorough breeding would be expected to produce, and at this point that we need to review three prominent examples of where cyber liability and technology E&O insurers are not only giving their enemy, hackers, the upper hand but are also endangering their own existence.

Perhaps one of the most recent blatant examples of how insurers are failing their lineal forebears occurred towards the end of 2018 when an insurer created a partnership with one of the world’s largest e-commerce merchants for the express purpose of providing physical cyber tools to policyholders to help “protect” homes. All of the available evidence suggests that the cyber tools were championed by the insurer without the organization having done considerable research on, and the testing of, the physical devices to ensure that they were highly resistant to being hacked. None of the products the insurer recommended were rated as “secure” by any respected independent testing lab. In fact, none of the products were rated “secure” on the manufacturer’s website. For a cyber liability insurer that also offers homeowners and renters insurance, the
championing of such products directly undermined the insurer’s cybersecurity credibility, sullied its pedigree, and all for marginally increasing its bottom line.

Another timely and alarming example of an unfortunate mistake of cyber liability insurers are the recent creations of the Global Cyber Alliance and the Cybersecurity Tech Accord. The effort of both is to create a cooperative atmosphere in the private sector to combat cybersecurity threats while also working to provide responsible cyber products. There are many respectable companies that belong to each organization, but not one cyber liability or technology E&O insurer can be found among the members of either organization. When we read in the news that company ABC suffered a $40 million data breach, that means, assuming the organization had a cyber liability policy, that millions of dollars are being lost by the cyber liability insurer. Due to the current and highly competitive cyber market, the premiums of cyber liability policies are not typically commensurate with the amount of risk and financial loss in order to appropriately offset the millions of dollars the insurers pay out in such a breach. Thus, insurers mistakenly are not advocating or supporting the very organizations, like the Cyber Tech Accord, that are indirectly trying to help them reduce their losses and those of their clients.

Illustrative of a mistake by cyber liability insurers in this matter is something that insurers say. It is not uncommon to read in a cyber liability brochure that the insurer is not going to restore a client to a better state than the one the policyholder had prior to a cyber breach. On its face the logic is reasonable and even is in the pedigree of fire insurance companies. After all, fire insurance companies would not build a person a five bedroom, four bath, home with a four car garage when a person’s two bedroom, one bath home with no garage burned down. However, fire insurance also followed the principle of indemnity, and that principle clearly states that an insured is to be restored to her original condition after a fire. However, cyber liability insurance policies DO NOT FOLLOW the principle of indemnity, and that distinction matters considerably. There is no reasonable way to calculate how much a cyber liability breach will cost an insured or her cyber liability insurer. After all, laws across the United States, let alone the world, vary in their intent and letter as to what needs to be done after a cyber breach.

Not only that, but the size of a company, how a company was breached, when it was breached, what was stolen, if anything, what was done with what was stolen, and a number of other important factors inextricably but subjectively determine the impact a breach will have on a client. That those factors are subjective in their cost means that all insurers have no accurate way of determining the cost of a breach. When a $500,000 home burned down an insurer could reasonably expect the cost of replacing that home to be within a certain percentage of $500,000. When a major retailer suffered a cyber breach in 2013, the annual report the following year specifically stated that it did not know what the true cost of the breach would be, but it was expecting the cost to increase beyond the initial amount. If such a policyholder was unable to determine the true cost of the breach, then how could the insurers of its cyber liability policy know either?

One of the major tools fire insurance companies used in the past to combat fires was to understand how susceptible a building material was to being damaged by fires. However, to this date cyber liability insurers have not founded an institute funded by themselves and created for the express purpose of determining the quality of products that have a direct impact on policyholders’ ability to resist attack. This in turn creates an inextricable link to a policyholder’s sense of cyber security safety. Cyber liability organizations sometimes use the services of a cybersecurity firm to determine, prior to underwriting a policy, if an applicant’s network exhibits any signs of unusual network activity that could be suggestive of a cyber breach. However, that is an inadequate way of providing a policyholder with any meaningful comfort, let alone allowing an insurer to have a solid basis to believe a risk is worth underwriting. In fact, presently the closest organizations that exist for the express purpose of determining a product’s cybersecurity strength is Cyber ITL (Independent Testing Lab) and the NIST (National Institute of Standards and Technology). However, neither of those firms were created by insurance companies and neither has the vested interest that insurers have in protecting their policyholders and guaranteeing cyber liability remains profitable to underwrite. Therefore, it is time for all cyber liability insurers to either join with an organization like Cyber ITL or to create their own like-kind organization. The browser application, the version number of a browser application, what operating system is used, what kind of router a computer is connected to, what

used, what kind of router a computer is connected to, what
kind of firewall is in place, and numerous other factors all play a part in increasing or decreasing the strength of users’ cybersecurity. However, until cyber liability insurers measure and rate everything that pertains to cybersecurity, they and a vast majority of their clients will be allowing hackers to gain an undeserved advantage.

Beyond the need for an independent testing lab there are other measures that insurers need to take, and these measures have been previously proposed. However, it is extremely unfortunate that insurers have yet to rally to the cause of their clientele by implementing the following strategies.

In the April 2016 edition of the PLUS Journal it was argued that insurers need to work with other companies involved in technology, marketing, lending, and in other parts of the private sector to create an international competition. This competition would give students a creative outlet to display their skills whether they be in coding, design, or writing. By establishing such a competition and working with educators, worldwide insurers and other companies can give pre-college students the ability to demonstrate, on a world stage, the ingenuity and adaptive reasoning that bright young people often possess. However, the benefit of the competition is not only for the students; it absolutely benefits the corporate sponsors of the international competition. For insurers, it allows them to persuade students that the insurance realm is a viable and worthwhile place in which to work. It also allows insurers to gain the opportunity to create a list of candidates from which to recruit when the winners of the international competition graduate from university. The same list of students that insurers create can also be used for their clients when they need to hire a software engineer or a laureate. If insurers have some of the brightest and most talented young people working for them, they can create more efficient internal systems, more advanced lines of insurance coverage, and they can also provide better methods for ensuring that their policyholders have the right tools with which to mitigate cybersecurity risk. Additionally, it is not profitable nor reasonable to believe that cyber liability follows the principle of indemnity, because believing that hurts the insurer and, to a greater extent, the insured. If an insured uses the same computer, router, browser, and other items after a breach has been fixed that were used prior to the breach, then there is nothing to stop another breach from occurring. In the near term, to reduce the number of clients suffering reoccurring breaches, an insurer should pay for one year of monitoring by a respectable cybersecurity firm. It would also be useful to conduct an on-site visit by an auditor three to six months after the original breach has been fixed to see what steps the insured has taken to prevent future ones. In time, if an independent testing lab is established, an insurer could even offer a policyholder an improved router and firewall to further protect the client. The less susceptible any client is to an attack, the less likely a claim will arise, and fewer claims means more underwriting profit.

However, technology E&O insurers also bear a responsibility for helping to prevent cyber breaches as well. After all, how well a software engineer or an electrical engineer professional writes software code or builds physical products is the basic element that will later determine, to a high degree, whether a breach occurs or not. Technology E&O insurers need to work with universities to establish teaching standards that are uniform across the globe and engineering standards in the workplace that establish the highest minimum standard possible. In the January 2016 edition of the PLUS Journal it was also demonstrated that technology E&O policies can be written to encourage more responsible software engineering practices to further minimize claims. If the above practices are put into place, then perhaps lives lost to faulty software, like those in the recent two plane crashes of a U.S. based commercial jet manufacturer, need not happen in the future.

The closest fire insurance companies had to a dynamic enemy were arsonists, who were few and far between. Despite the general absence of an active enemy, those organizations spent about 200 years directly influencing the development of urban landscapes whether through building codes or the layout of a city. Today, their efforts have largely paid off because they acknowledged the challenges they faced and met them with courage and creativity. They did not accept that they could do nothing to make their clients safe or secure their profitability. However, today beyond a few web portals that insurers or third parties have created that can provide minor tools to a policyholder, and beyond creating semi-close relationships with some members of the cybersecurity community, cyber liability and technology E&O insurers have spent a significant part of the 21st century accepting losses, writing checks,
and never acknowledging that hackers and poorly crafted technology products are their mortal enemies. Hackers are costing the global economy tens of billions of dollars, if not more, every year, and businesses are closing or suffering severe financial loss because of cyber breaches. How many more people must die and how much insecurity must exist in this world before insurers acknowledge that the war is here, and the enemy is at the doors of organized, civilized societies? When will insurers take the prudent course and glean from history and their forebears all of the lessons they offer, and in so doing prove that they are worthy of their trust?

ABOUT THE AUTHOR

JESSE LYON

Jesse Lyon is a cyber thought leader with nine published papers on cyber liability and technology E&O, plus one paper that introduced the insurance sector to robotic liability. He has been published in the U.S. and the U.K. and he continues to advocate for sound underwriting principles.
Action movies aren’t the only hits coming out of Hollywood this Summer. In Office Depot, Inc. v. AIG Specialty Insurance Company, Case No. 15-cv-2416 (C.D. Cal. Jun. 21, 2019), the United States District Court for the Central District of California issued a “must-see” opinion finding that – not one, not two, but three liability policy exclusions separately and independently barred coverage for a qui tam lawsuit. While the case is pending an appeal to the Ninth Circuit,¹ the decision is important for several reasons. First, the decision underscores the principle that broadly worded exclusions should be applied broadly. Second, the decision provides an instructive “but for” test in applying the contractual liability exclusion carve-back for “liability or obligation an Insured would have in the absence of such contract or agreement.” Finally, the decision confirms that qui tam lawsuits are in fact brought “by or on behalf” of a government agency, and that the plain language of regulatory exclusions will generally be upheld.

BY: MAURICE PESSO GREG STEINBERG MICHAEL GOLDWASSER
Claim Background: The Sherwin Action

In March 2009, a qui tam relator and former Office Depot employee filed a complaint under seal against Office Depot. The Sherwin Action was brought on behalf of over 1,000 California state and local government entities, including over 60 school districts and regional agencies, which were allegedly overcharged by Office Depot through a variety of underhanded pricing practices.

The Sherwin Action involved a supply contract between Office Depot and the U.S. Communities Government Purchasing Alliance (the “USC Contract”), a non-profit that maintains procurement contracts for the purchase of goods and services by state and local public entities. From 1996 to 2010, the USC Contract was negotiated and managed by lead public entity Los Angeles County, and adopted and subscribed to by numerous other California counties, cities, school districts and regional agencies through an administrative agreement between U.S. Communities and Office Depot. At the time of the Sherwin Action, the USC Contract was Office Depot’s single largest contract.

It was Office Depot’s alleged fraudulent conduct in overcharging the government entities who opted into the USC Contract that was at the heart of the Sherwin Action. Specifically, it was alleged that Office Depot engaged in an overcharging scheme that involved: (1) falsely promising in marketing materials that the plaintiffs would receive the best pricing available to any government entity through provisions in the USC Contract; (2) causing the plaintiffs to switch to higher pricing structures and using its catalogues and website to disguise the increased charges resulting from the switch; (3) misrepresenting costs by excluding manufacturer rebates, so it could charge more under the USC Contract for non-core items; (4) changing its prices frequently and without disclosure, despite its commitment under the USC Contract to increase prices only twice per year; and (5) discontinuing products on its core list so it could charge more for a comparable item on the non-core list, or for a private-label item.

The operative complaint in the Sherwin Action contained a single cause of action against Office Depot for violation of the California False Claims Act for “knowingly present[ing] . . . false and fraudulent claims, and knowingly fail[ing] to disclose material facts, in order to obtain payment and approval” from the plaintiff government entities. Similarly, an additional 19 California political subdivision intervenors asserted common-law fraud and breach of contract in addition to their own False Claims Act allegations.

Following mediation in 2014, Office Depot settled the Sherwin Action by agreeing to pay $77.5 million, consisting of $68.5 million in damages and $9 million in attorneys’ fees. The Sherwin Action was settled and dismissed before any factual determinations were made, and without any admission of liability by Office Depot.

The Office Depot Coverage Action

After the qui tam complaint was unsealed and served on Office Depot in 2012, Office Depot tendered the complaint for defense and indemnity coverage under two consecutive media liability insurance policies issued by AIG. AIG denied coverage on several grounds, including a Contractual Liability Exclusion, the Prior Acts Exclusion, and the Regulatory Exclusion. Office Depot then filed a complaint for declaratory judgment and breach of contract action against AIG. The parties filed cross-motions for partial summary judgment on AIG’s duty to defend and indemnify.

On June 21, 2019, the district court issued an opinion holding that AIG had no duty to defend or indemnify Office Depot. As an initial matter, the court addressed whether the Sherwin Action even triggered the insuring agreements of the AIG policies. The policies provided that AIG would provide coverage for Office Depot’s wrongful acts as long as the wrongful acts first occurred during the policy period. Therefore, the threshold issue was whether Office Depot’s wrongful acts first occurred during the policy periods of March 8, 2007 through March 8, 2008 or March 8, 2008 through March 8, 2009. Because the Sherwin Action sought damages for sales transactions over a ten-year period starting in 2001 and continuing through 2011, the court concluded that the wrongful acts alleged did not first take place during the relevant policy periods. Accordingly, the court held that the Sherwin Action did not trigger the AIG policies.

The court could have stopped there—but it didn’t. The court further held that, even if the Sherwin Action
triggered the insuring agreement, coverage was separately and independently barred by the Contractual Liability Exclusion, the Prior Acts Exclusion, and the Regulatory Exclusion.

1. The Contractual Liability Exclusion

The Contractual Liability Exclusion excluded coverage for any claim “alleging, arising out of or resulting, directly or indirectly, from any liability or obligation under contract or agreement or out of any breach of contract.”

AIG argued that coverage for the Sherwin Action was precluded in its entirety by the Contractual Liability Exclusion because the Sherwin Action “arises out of” Office Depot’s contractual obligations under the USC Contract, notwithstanding the non-breach of contract causes of action. AIG pointed to the fact that the operative complaint was replete with contract-based allegations, and that Office Depot itself had confirmed the contractual nature of the case in testimony and filings during the Sherwin Action. In describing the gravamen of the Sherwin Action, Office Depot’s in-house counsel had testified that “this is a complaint for violation of the False Claims Act, but the claims and allegations that he made were related to our performance or nonperformance of our government contracts.”

Office Depot argued that the Contractual Liability Exclusion did not apply because it contained a carve-back for “liability or obligation [Office Depot] would have had in the absence of such contract or agreement.” Office Depot itself had confirmed the contractual nature of the case in testimony and filings during the Sherwin Action. In describing the gravamen of the Sherwin Action, Office Depot’s in-house counsel had testified that “this is a complaint for violation of the False Claims Act, but the claims and allegations that he made were related to our performance or nonperformance of our government contracts.”

The court agreed with AIG. Typically, courts grapple with the difference between narrow “for” exclusions and broad “arising out of” exclusions. Here, the court went one step further, noting that the exclusion in the AIG Policy was even broader than a typical “arising out of” exclusion:

[T]he exclusion here is much broader than a typical “breach of contract” exclusion; it excludes not only claims arising out of a breach of contract but also claims alleging, arising out of, or resulting, even indirectly, from any liability or obligation under any contract or agreement. The distinction is crucial because the additional breadth excludes claims that are not strictly contractual.

Second, the court analyzed the exclusion’s carve-back for “liability or obligation an Insured would have in the absence of such contract or agreement” under a “but for” test. Specifically, the court determined that the False Claims Act and common-law claims would have not existed but for the USC Contract:

Even if CFCA and fraud claims are not breach-of-contract legal theories, under the factual allegations of the Sherwin Lawsuit the allegedly wrongful conduct would not have existed without the Master Agreements and U.S. Communities Contract. Thus, even if the exclusion were limited to claims arising out of a breach of contract . . . the exclusion would still bar coverage of the wrongful acts alleged in the Sherwin Lawsuit.

Therefore, the court concluded: “On its face, this exclusion applies; under any reasonable interpretation of the exclusionary language, the Sherwin [Action] alleged, arose out of, or resulted, indirectly (if not directly), from Office Depot’s obligations under the [USC Contract].”

2. The Prior Acts Exclusion

The Prior Acts Exclusion excluded coverage for any claim “alleging, arising out of or resulting, directly or indirectly, from any wrongful act, related wrongful act or series of continuous or repeated wrongful acts where the first such wrongful act first occurs prior to the inception of or subsequent to the termination of the policy period.” First, the court reaffirmed the broad nature of the “arising out of” language in the Prior Acts Exclusion:

[The Prior Acts Exclusion] bars coverage of claims alleging, arising out of, or resulting, even indirectly, from any wrongful act, related wrongful acts, or series of continuous or repeated wrongful acts where the first wrongful act occurs prior to the inception of the policy period. This language makes clear that the exclusion groups all “related” or “series of” wrongful acts. If the first of many related wrongful acts occurred prior to the inception of the policy period, all such related acts are excluded from coverage [emphasis court’s].

Next, the court related all of Office Depot’s alleged wrongful acts as set forth in the Sherwin Action. Therefore, the Office
Depot decision can be cited in other cases involving broad exclusionary language and wrongful acts occurring both before and after the relevant prior acts date. In these cases, as supported by the rationale in Office Depot, even if there are wrongful acts occurring after the relevant prior acts date, coverage for the entire complaint may still be excluded because: (1) the exclusion applies to the entire “Claim” (i.e., the complaint or civil proceeding), and/or (2) the prior acts exclusion contains broad aggregation language excluding coverage not just for the prior acts themselves, but any related acts.

3. The Regulatory Exclusion

The Regulatory Exclusion excluded coverage for any claim “that is brought by or on behalf of the Federal Trade Commission, the Department of Health and Human Services, the Office of Civil Rights, the Federal Communications Commission, or any other federal, state or local government agency, or foreign government agency.”

AIG argued that, by definition, a qui tam lawsuit under the California False Claims Act like the Sherwin Action falls within the Regulatory Exclusion because they are brought by or on behalf of government agencies. In this regard, the relevant California statutory qui tam provision provides that a qui tam plaintiff brings his or her action either for the State of California itself or for a “political subdivision.” Under the statute, a “political subdivision” is expressly listed as a type of “local government agency.”

Office Depot argued that the statutory definitions were irrelevant, and that the phrase “federal, state or local government agency” as used in the Regulatory Exclusion should be read in the context of the specific agencies listed and therefore is meant to refer only to an agency bringing an administrative or regulatory proceeding or claim.

The court agreed with AIG, and held that the Regulatory Exclusion also barred coverage for the Sherwin Action because a qui tam lawsuit is brought “by or on behalf of” a government agency. In doing so, the court upheld the plain language of the exclusion and enforced the policy language as written. Even though the State of California was not specifically listed in the exclusion, the Regulatory Exclusion included “any other federal, state or local government agency, or foreign government agency.”

Looking Ahead


While sequels hardly ever live up to the original, there are always exceptions (*The Godfather Part II*, *Terminator 2*). So, while the Ninth Circuit’s opinion could be a brief three-page opinion, it’s also possible that the Ninth Circuit’s decision will include a robust discussion of the broad preamble language, the carve-back to the Contractual Liability Exclusion, and the aggregation language in the Prior Acts Exclusion. That alone would be worth the price of admission. Stay tuned . . .
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End Notes

1. Office Depot’s opening brief is currently due October 25, 2019.
2. State of California et al., ex rel. David Sherwin v. Office Depot, Inc., Case No. BC410135 (Superior Court, Los Angeles County) (the “Sherwin Action”).
3. Office Depot, Inc. v. AIG Specialty Insurance Company, Case No. 15-cv-2416 (C.D. Cal.).
The Leo Gilmartin Scholarship is an important part of the PLUS Foundation’s commitment to education and serving the Society’s membership. Since 1996 PLUS and the Foundation have awarded four-year college scholarships to children of PLUS members and sponsor company employees. This competitive scholarship recognizes excellence in academics, extracurricular activities and community service with awards of $12,000 each. Ninety scholarships have been awarded since the program’s inception.

NICHOLAS FRANK

of Washington, D.C., was a member of the National Honor Society, a National Hispanic Merit Scholar and an AP Scholar with Distinction. He volunteered as a D.C. Youth Civil Rights Summit Coordinator, served in the Model UN and participated on the golf and ski teams. Mr. Frank will attend UCLA to study political science and government.

ANNALISA GALIOTO

of Chanhassen, MN, spent four years on the Student Council and served as the President. She also was on the ski and dance teams, and in math league. She won the National Presidential Service Award and was an AP National Scholar. Ms. Galioto will attend Villanova University to study business.

JOHN LABBATE

of Glen Head, NY, was a member of the National Honor Society, the Tri-Music Honor Society and Mu Alpha Theta Mathematics Honor Society. He served as the Student Government Organization President and was captain of the soccer team. Mr. Labbate will attend Northwestern University to study engineering.

MAURA MCCARTHY

of Severna Park, MD, was a member of the National Honor Society and a national AP Scholar. She was the Student Government Vice President and Varsity Soccer Captain. She also volunteered her time on a service trip to the Dominican Republic. Ms. McCarthy will attend the College of William and Mary to study environmental sciences.
Consistent with our mission of philanthropy and the advancement of education, the PLUS Foundation aims to help families and students afford higher education. This step expands on our record of service to and on behalf of the professional liability community.

- The success of the PL industry relies on many employees who may be of varied financial means who move our business forward.
- With the cost of education rising dramatically, many deserving students struggle to attend the college of their choice...or any college at all.
- This scholarship directs foundation resources to the colleagues and families of our members, creating more personal and closer connections within our PLUS community.

The PLUS Foundation is pleased to announce these Financial Aid Scholarships, made possible by the personal donations of leaders in our industry:

- Constantine “Dinos” Iordanou Scholarship
- H. Seymour Weinstein Scholarship
- Elizabeth Everson Seyler and Mary Quayle Bradley Scholarship
- Friends Giving Back Scholarship

FIVE FINANCIAL AID SCHOLARSHIPS HAVE BEEN AWARDED FOR 2019:

**Abigail Griffin**
From North Reading, PA, Abigail won the National Honor Society and received the Excellence in Business Award. She served as President of the Interact Club, Student Leadership and Mentoring and Students to End Alzheimer’s Disease. Ms. Griffin will attend Middlebury College to study biology.

**Samuel Gunn**
From Chagrin Falls, OH, Samuel was on the High Honor Roll and Merit Roll. He played on the high school basketball team and served as the team manager. He also volunteered his time for work with the Cleveland Metroparks. Mr. Gunn will attend Clemson University to study business.
From Chino, CA, Nicolas was in the National Honor Society, National Math Honor Society, and was an AP Scholar. He served as Captain of the Varsity Soccer team and as Captain of the Varsity Track team and worked with the Robotics Club. Mr. Leon will attend Pomona College to study for his bachelor’s degree.

From Bethpage, NY, Marcus was a member of the National Honor Society and the Spanish Club. He also played football and was on the varsity wrestling team. He captained a team for the Relay for Life and volunteered with Long Island Care. Mr. Torres will attend Syracuse University and study engineering.

From Douglasville, GA, Joseph was on the All A Honor Roll and received the Superintendent Scholar Award. He participated with the Georgia All-State Chorus and the Atlanta Young Singers. He also served as Captain of the Robotic Club. Mr. Steele will attend Georgia Institute of Technology and study music technology.

Each of these students represents the strong level of academic and community achievement that the Foundation looks for when awarding these scholarships. We wish them the best in their future endeavors.
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AN UPDATE ON LIFE AFTER Cyan

BY: TAMMY YUEN, EDWARD CARLETON, AND KATELYN RAUH

Since the Supreme Court’s March 2018 decision in Cyan, Inc. v. Beaver County Employees Retirement Fund, state courts have seen a significant rise in securities class action filings under Section 11 of the Securities Act of 1933. The Cyan ruling, which resolved a circuit split concerning whether state and federal courts have concurrent jurisdiction over Section 11 claims, allows plaintiffs to bring Section 11 cases in state court, thereby sidestepping many of the federal statutory procedural reforms intended to curb frivolous claims.

In the 18 months since the holding, the fears of D&O industry prognosticators have largely come to fruition. Section 11 class action litigation is in many cases now more onerous and expensive, complicating the process of access to public investment capital. This article revisits the path to Cyan and discusses the post-Cyan state court litigation landscape as we see it from our perspective as D&O insurance law practitioners.
A. Legislative History

The Securities Act of 1933 (the “1933 Act”) was passed in the wake of the stock market crash of 1929 and was designed to ensure that investors receive complete and accurate disclosures from entities seeking access to public markets. Section 11 of the 1933 Act creates a private right of action for shareholders who purchase securities in connection with a registration statement that “contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” Section 11 imposes a standard of strict liability that extends to issuers, directors, underwriters, experts, and others who sign, prepare, or certify all or any part of the registration statement. Generally, a Section 11 suit is brought as a class action by shareholders who purchased securities in an initial public offering.

The jurisdictional provision of the 1933 Act expressly provides that both state and federal courts have concurrent jurisdiction over cases brought exclusively under the 1933 Act, including Section 11 claims. It also prohibits the removal of such actions from state to federal court.

In response to perceived abuses of the class-action vehicle in securities litigations and in an effort to limit frivolous securities lawsuits, Congress passed the Private Securities Litigation Reform Act of 1955 (“PSLRA”). The PSLRA implemented several substantive and procedural changes to the 1933 Act, including certain procedural safeguards that directly affect Section 11 claims and are often considered “defense friendly.”

First, the PSLRA directs courts to apply a rebuttable presumption that the plaintiff with the largest financial stake in the case should serve as the lead plaintiff. This provision, known as the “Lead Plaintiff Provision,” was designed to shift control of securities class actions away from lawyers racing to the courthouse to file the first complaint on behalf of “professional plaintiffs” who lacked a meaningful economic stake in the outcome of the case. In addition, any plaintiff seeking to serve as a class representative must certify that they did not purchase the security in question at the direction of counsel.

Second, the PSLRA provides for an automatic stay of discovery until a motion to dismiss is denied. The rationale behind this provision was two-fold: it saves defendants the expense of discovery in a case that might be dismissed, and it prevents plaintiffs from filing a case without having sufficient information to survive a motion to dismiss.

Although the PSLRA enacted substantive reforms applicable to cases brought in both federal and state courts, its procedural reforms were only made applicable at the federal level. Thus, plaintiffs sought to avoid these defense-friendly hurdles by filing class actions under state law.

Three years later, in 1988, Congress responded to this unintended loophole by enacting the Securities Litigation Uniform Standards Act (“SLUSA”). SLUSA amended the 1933 Act’s jurisdictional provision in two key ways. First, it precludes “covered class actions” brought under state law in both state and federal courts. “Covered class actions” is defined as a class action in which “damages are sought on behalf of more than 50 persons.” Second, SLUSA allows for the removal of covered class actions to federal court to guarantee dismissal of state court claims. Except for authorizing removal in this limited circumstance, SLUSA otherwise preserves the 1933 Act’s anti-removal provision.

In the years following the enactment of SLUSA, there was a significant circuit split over whether plaintiffs were still permitted to bring Section 11 claims in state court and whether defendants were permitted to remove such lawsuits to federal court for dismissal. The Ninth Circuit, which includes California, did not allow for removal of Section 11 claims. In contrast, the Second Circuit, which includes New York, did. The Supreme Court resolved this split with its holding in Cyan.

B. The Supreme Court’s Cyan Decision

Cyan was a Section 11 class action case brought by a group of more than fifty investors whose stock purchases declined in value following Cyan’s initial public offering. Plaintiffs alleged that Cyan violated Section 11 of the 1933 Act by filing an inaccurate and misleading registration statement in connection with its initial public offering because the prospectus did not disclose anticipated issues with the company’s revenue stream which issues ultimately led to
a sharp decrease in the stock price. Plaintiffs did not assert any state law claims. Cyan moved to dismiss the claims, arguing that the court lacked subject matter jurisdiction because under SLUSA, all claims brought under the 1933 Act must be brought in federal court. The Supreme Court ruled unanimously against Cyan, holding that SLUSA did not change the 1933 Act’s jurisdictional provision. Thus, plaintiffs may file suit in state courts for violations of the 1933 Act, and defendants may not remove such cases to federal court.

The Court’s analysis can be broken down into two parts, both aimed at attempting to discern Congress’ intent: an analysis of SLUSA’s text and of its legislative history. First, the Court noted that SLUSA amended the jurisdictional provision of the 1933 Act to add the following italicized language: “The district courts of the United States . . . shall have jurisdiction . . . concurrent with State and Territorial courts, except as provided in section 77p of this title with respect to covered class actions” of cases brought pursuant to the 1933 Act. It referred to this italicized language as the “except clause.” According to the Court, “the critical question for this case is therefore whether § 77p limits state-court jurisdiction over class actions brought under the 1933 Act. It does not.”

The Court agreed with the investors that SLUSA’s amendment to the 1933 Act’s jurisdictional provision did not divest state courts of concurrent jurisdiction. The Court noted that the except clause contained a cross-reference to the entirety of Section 77p, which the Court found concerned state law actions. The Court rejected Cyan’s argument that the cross-reference to Section 77p was specifically to the definition of “covered class actions” contained in Section 77p(f)(2). The Court reasoned that if Congress wanted to refer to the definition of “covered class actions,” it could easily have done so by “adding a letter, a number, and few parentheticals.” Further, it would be unprecedented for Congress to cross-reference a definition as providing an exception to a rule.

The Court also rejected Cyan’s argument that the legislative history and purpose of SLUSA were further evidence that it stripped state courts of jurisdiction. The Court explained that the purpose of SLUSA was to limit plaintiffs’ ability to bring state law securities claims, and “[t]hat object—which SLUSA’s text actually reflects—does not depend on stripping state courts of jurisdiction over 1933 Act class suits, as Cyan proposes.” With respect to the removal issue, the court looked to the statutory definition of “covered class actions” which does not include federal lawsuits. Thus, SLUSA’s exception to the 1933 Act’s anti-removal provision does not apply to claims brought under the 1933 Act. Put another way, defendants cannot remove to federal court any Section 11 claims filed in state court.

C. Cyan’s Implications

As noted by virtually every commentator at the time of the ruling, the Cyan decision significantly increased risk that a public issuer could be subject to a state court Section 11 claim. The immediate and practical consequence of Cyan felt by D&O insurers, which is supported by published data, is that issuers increasingly find themselves defending concurrent securities claims in state and federal courts where shareholders assert liability under Section 11 and Section 10(b) of the Securities Exchange Act of 1934. As noted above, a defendant hit with a Section 11 claim in state court will be unable to remove the lawsuit to federal court. Making matters worse, there is no procedural mechanism to consolidate or coordinate parallel cases pending in both state and federal courts. This not only complicates a company’s defense, but it also presents the prospect of substantially increased defense fees and inconsistent rulings in competing fora.

Besides Cyan opening up more fora to plaintiffs, another cause for concern is the lack of procedural protections available to defendants in state court venues. State courts are often assumed to be “pro-plaintiff,” partly because dismissal rates are much lower than they are in federal court. This is largely due to state courts having far lower pleading standards, many requiring no more than notice pleading. For example, in California—where many Section 11 cases are filed—a plaintiff must only plead a “statement of the facts constituting the cause of action, in ordinary and concise language.” This standard is even lower than the plausibility standard established by Bell Atlantic Corp v. Twombly and Ashcroft v. Iqbal.

Not surprisingly, recent data suggests that plaintiffs are embracing state court venues with open arms. According to a study conducted by Cornerstone Research, in the
first half of 2019, 19 cases alleging 1933 Act claims were brought in state courts, and over one-third of the cases had a parallel federal filing. In 2018, plaintiffs filed 30 securities class actions in state courts. This is three times the average filing rate from 2010 to 2017, and almost double the amount of cases filed in state courts in 2017. Of the 30 cases filed in 2018, 13 had parallel proceedings in state and federal courts. This is more than double the annual average filing rate from 2010 to 2017.

With respect to dismissal rates, the report confirms that the concerns of lower dismissal rates in state Section 11 cases are more than justified. From 2010 to 2017, only 33% of state Section 11 filings were dismissed. This is compared to 48% of federal Section 11 filings.

D. Post Cyan Uncertainties

In the aftermath of Cyan, states have wrestled with an issue left unaddressed by the Supreme Court: whether the PSLRA discovery stay applies to state court proceedings. The state courts are divided on this issue.

In separate rulings in July 2019 and August 2019, New York Supreme Court Justice Saliann Scarpulla held that the discovery stay does not apply to cases brought in state court and to hold otherwise would “undermine Cyan’s holding” that state courts can adjudicate 1933 Act cases. Last year, a California state court reached the same conclusion, finding that the discovery stay is of a procedural nature and thus does not apply to state court cases.

However, in August 2019, a different New York state judge took the opposite approach, finding that the discovery stay applies to both federal and state court proceedings. Justice Andrew Borrok found that Cyan “did not control” the question before him because Cyan only addressed the jurisdictional issue concerning whether SLUSA barred state courts from hearing 1933 Act claims and whether those cases could be removed to federal court. Rather, Justice Borrok focused his analysis on statutory interpretation principles and held that, “The simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss ‘in any private action arising under this subchapter[.]’” He noted that nothing in the statute indicates that the discovery stay only applies to cases brought in federal court. Earlier this year, a Connecticut court reached the same conclusion. Connecticut Superior Court Judge Charles T. Lee held that the absence of statutory language limiting the discovery stay to federal courts implies that Congress intended it to apply to both federal and state courts.

E. Looking Forward

In response to the post-Cyan spark in state 1933 Act filings and the inconsistent rulings dismissing these state court actions, issuers have struggled to limit the impact of Cyan. Almost immediately after Cyan was decided, many companies opted to include a federal forum bylaw or charter provision prior to going public that required purchasers to bring any Section 11 claim in federal court. While creative, these efforts were shot down by a Delaware court. In December 2018, the Delaware Court of Chancery held that these forum selection provisions are invalid because Delaware law does not authorize a corporation to regulate external relationships, as opposed to internal relationships such as the duties of the board to the welfare of the entity. Under current Delaware law, corporations can include forum selection provisions for internal claims involving “rights or relationships that were established under Delaware’s law.” However, Delaware courts have held that 1933 Act claims are external to a corporation because “federal law creates the claim, defines the elements of the claim, and specifies who can be a plaintiff or a defendant.” Thus, the Court of Chancery held that the bylaws of companies incorporated in Delaware cannot dictate the forum for bringing 1933 Act claims. The ruling was appealed, including most recently on August 5, 2019.

Another logical, albeit challenging, alternative is to have Congress address the problem. In February 2019, the U.S. Chamber of Commerce-backed Institute for Legal Reform issued a report calling on Congress to overturn Cyan to ensure that federal securities class actions are only heard in federal court. The report focuses on the increasing rate of filings with parallel proceedings and highlights the increased risk faced by securities’ defendants. As of now, Congress has yet to act, and given the current state of political gridlock and Congress’ apparent lack of interest in supporting any bi-partisan legislation, securities litigation reform seems an unlikely bipartisan undertaking.

With no immediate solution in sight, in the intermediate term, companies going public in the post-Cyan environment should expect to face increased litigation
exposure. It remains to be seen how and to what extent this risk can be managed by issuers and their D&O insurers.

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END NOTES

25 U.S. Chamber Institute for Legal Reform, Containing the Contagion – Proposals to Reform the Broken Securities Class Action System (2019).
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WHICH LAWYER WAS RESPONSIBLE?

Analyzing When the Negligence of a Succeeding Attorney on a Matter Can Be Said to Absolve the Former Attorney’s Malpractice

When legal malpractice is alleged, it is not uncommon for such claims to arise in circumstances where more than one set of attorneys has represented the alleged victim of the malpractice. Where this has happened, assuming malpractice has, in fact, occurred, a question will arise as to whether one or both of the lawyers involved in the representation should be held responsible, in whole or in part. An argument that can sometimes be made by successor counsel is that injury caused by the malpractice had occurred before successor counsel became involved. Thus, the predecessor counsel should be held liable for the loss in its entirety, and nothing successor counsel did or failed to do afterwards caused or contributed to it. Conversely, an argument can sometimes be made by predecessor counsel that the conduct of the successor counsel was also negligent, and not just intervening negligence, but a “superseding intervening cause” of the injury/loss, such that any negligence on the part of the predecessor counsel cannot be considered a proximate cause of the client’s loss – in effect wiping it off the ledger.
While it may be the case that what the first lawyer did or didn't do bears no relationship to what the second lawyer did or didn't do, it is not atypical for the roots of the malpractice to have formed during the course of the first lawyer's involvement. The question is, when does the conduct of the second lawyer merely contribute to the legal malpractice, and when does it constitute a superseding intervening cause such that the first lawyer is taken off the hook and all liability rests with the successor attorney?

I. What is a Superseding Intervening Cause?

The issue of whether negligence constitutes a superseding intervening cause is one that often arises in personal injury litigation. As an example, an individual leaves his car at a garage to be repaired, and a mechanic at the garage leaves the car parked on the street, with the keys in the ignition. The car is then stolen, and while driving the stolen vehicle, the thief runs through a stop sign and hits a woman crossing the street, causing her injuries. To the extent the woman was to sue the garage for her injuries, the courts would in all likelihood find that while the garage's employee was clearly negligent, the intervention of the thief and his reckless driving of the stolen vehicle was a superseding intervening cause of the loss. Conversely, if a person drives a car recklessly, and in so doing causes an accident leading to personal injuries, and subsequently the emergency medical technician (“EMT”) who arrives on the scene mishandles the care of an injured individual, the likelihood is that the negligence of the EMT is not going to be seen as a superseding intervening cause of the injuries suffered by the victim of the car accident. Why? What is the differentiator between an intervening cause that contributes to a loss and a superseding intervening cause that absolves the original negligent actor of liability to the victim? The answer lies in a determination of whether the second intervening act was reasonably foreseeable.

In the first scenario, the fact that leaving car keys in the car's ignition on the street might result in the car being stolen is clearly foreseeable. But it is not foreseeable that the driver of the stolen car would necessarily drive recklessly and as a result injure a pedestrian as a result of the keys being left in the ignition. In the second scenario, not only is it reasonably foreseeable that if you are driving recklessly you might injure someone, but it is also foreseeable that during the course of rushed efforts to provide emergency treatment to the individual injured by your reckless driving, the treatment might be delivered negligently, causing further harm.

Guidance in understanding where to draw the line between something being merely an intervening cause of a loss and something being a superseding intervening cause of a loss can be drawn from the Restatement (Second) of Torts. Section 447 of the Restatement provides that a subsequent actor will not be a superseding cause if the original actor at the time of his negligence “should have realized that a third person might so act,” if a reasonable person would not regard the subsequent actor's conduct as “highly extraordinary,” or if the intervening act was a “normal consequence of a situation created by the actor's conduct and the manner in which it was done is not extraordinarily negligent.” The Restatement (Second) of Torts § 452 provides further that “the failure of a third person to act to prevent harm to another threatened by the actor's negligent conduct is [also] not a superseding cause,” except where the duty to prevent harm is found to have “shifted” from the actor to the third person by passage of time or otherwise.

II. Superseding Intervening Cause and Legal Malpractice

How does this apply in the context of legal malpractice? One way it can often arise is where a lawyer takes on a client, fails to timely bring suit or file a claim or notice of claim against the correct party for a substantial period of time, and then is replaced by a second lawyer who also fails to timely act to protect the client’s rights. Another way it could arise is, for example, in the context of a patent application. The first lawyer fails to properly file the application, but in theory the application could be amended or an appeal of the denial of the application could be pursued, but the second lawyer either fails to file the amended application, or botches the appeal. Who is responsible? The first lawyer? The second? Both in some part? The issue will turn on foreseeability of the second lawyer’s negligence. Consider this Scenario #1:

Firm A represents a client in a personal injury action
(“PI client”) against an owner of a property arising from a slip and fall on the property. During this representation, Firm A fails to identify the correct parties at the commencement of an action. Three months prior to the expiration of the applicable statute of limitations, the PI client terminates Firm A and retains Firm B to prosecute the action. During this time, if Firm B identifies additional parties, it could commence a claim against them without leave of court. Firm B fails to identify those additional parties prior to the expiration of the statute of limitations, and the claims are ultimately dismissed.

Compared with this Scenario #2:

Firm A represents a client in a personal injury action (“PI client”) against an owner of a property arising from a slip and fall on the property. Because it is a municipal agency, as a prerequisite to commencing such action in court, one of the potential parties must be served with a Notice of Claim within ninety (90) days of the accident. Failure to do so may be remedied only by application to the Court for permission to serve a late Notice of Claim, which may be granted at the Court’s discretion, and in no event can such application be made more than one year after the expiration of time to serve a Notice of Claim (as this is the statute of limitations for any such claim against this municipal entity).

During this representation, Firm A fails to identify the correct parties at the commencement of an action and the 90-day period to serve a Notice of Claim lapses. Nine months after the accident, PI client terminates Firm A and retains Firm B to prosecute the action. During this time, if Firm B identifies the proper party, it can only commence a claim against them with leave of court, which is not guaranteed. Firm B ultimately fails to identify the proper party until after the time that an application for leave may be requested and the claims are ultimately dismissed.

In the first scenario, the court would likely rule that the original law firm, Firm A, is off the hook, and can’t be found liable for the loss of the client’s rights to pursue his claims due to the passage of the statute of limitations. The reason is that, while it was arguably not good practice for the law firm not to immediately take the necessary steps to preserve and protect the client’s rights, and instead allowing several years to pass without doing so, the second lawyer had plenty of time to address the situation and there should have been every expectation that a reasonable lawyer in the circumstances, upon accepting the retention, would have investigated the available claims, identified the parties against whom such claims could be made, and researched the statute of limitations for pursuing such claims.

In the second situation, conversely, Firm A should still be responsible. This is because in that circumstance the legal rights had already been lost, and at best the failure of Firm B to pursue timely actions designed to recapture the lost legal right can be foreseen. Moreover, the fact that it remains an uncertainty whether any action of Firm B at any time could have reinstated the lost legal right makes the argument that the conduct of Firm B was a superseding intervening cause of the loss fatally speculative.

In the second situation, conversely, Firm A should still be responsible. This is because in that circumstance the legal rights had already been lost, and at best the failure of Firm B to pursue timely actions designed to recapture the lost legal right can be foreseen. Moreover, the fact that it remains an uncertainty whether any action of Firm B at any time could have reinstated the lost legal right makes the argument that the conduct of Firm B was a superseding intervening cause of the loss fatally speculative.

In Meiners v. Fortson & White, the Court of Appeals of Georgia addressed the issue of whether substitution of new counsel who negligently fails to cure the negligence of the first counsel (after being specifically apprised of the need to cure such negligence and with six months remaining to do so) absolves the first counsel of liability due to the superseding failure to cure. The Georgia Court, relying on the concept of foreseeability, found that in such circumstances the second counsel’s negligence cut off the first counsel’s liability as failure to cure after receiving notice was not foreseeable. The California Supreme Court has similarly held that “[a]n attorney cannot be held liable for failing to file an action prior to the expiration of the statute of limitations if he ceased to represent the client and was replaced by other counsel before the statute ran on the client’s action.” New York is, typically, no different. These principles hold true even if successor counsel is not specifically apprised of the need to cure.

Applying this law to Scenario #1, it appears rather clear on the facts presented that Firm B’s failure to timely commence an action against the proper party would constitute an intervening and superseding cause. Under Scenario #2, it is a little less clear. The distinctions between Scenario #1 and Scenario #2 arise from the “Notice of Claim” prerequisite. Prior to the expiration of the 90-day period, PI client has
an infallible legal right to commence an action. Once the 90-day period elapses without serving of such notice, PI client no longer has a legal right to bring a claim. Rather, PI client only has an outlet to potentially, but not certainly, reverse the forfeiture of the legal right. And finally, once the limitations period of one year and ninety days elapses, PI client loses all hope at reviving the right to assert a claim.

So in Scenario #2, can the succeeding attorney be a superseding intervening cause? If the succeeding counsel has six months to not cure, but attempt to cure by application to the court for leave, is a failure to identify the need to cure and bring such application a superseding intervening cause? How the courts will rule on this issue likely turns on the timing of the forfeiture of a legal right, and a line of cases in New York provides some guidance.

In *Glamm v. Allen*, the New York Court of Appeals tackled the issue of when a legal malpractice claim accrued for failure to timely file a Notice of Claim and failure to seek leave to file a late Notice of Claim. Specifically, the Court noted that it was “pure speculation as to whether or not the court would have allowed [the attorney] to file a late notice,” and therefore held that a claim for malpractice arises at the expiration of the 90-day period within which to file the Notice of Claim. In other words, under *Glamm*, no claim accrues from a purported failure to make an application for leave to cure a failure to timely serve a Notice of Claim. The point at which the legal right is lost is the triggering event. Although *Glamm* did not address predecessor counsel versus successor counsel, the New York Appellate Division did.

In *Grant v. LaTrace*, the New York Appellate Division denied a predecessor counsel’s motion to dismiss on the grounds of superseding intervening cause because the successor counsel could not have cured the predecessor’s negligence as of right. Specifically, the Court held:

[H]ere, the [successor counsel] could not have moved as of right to remedy defects in service alleged. The Supreme Court would have had to exercise its discretion in the underlying action to extend the time to serve process (see CPLR 306-b, CPLR 2004), and it is pure speculation as to whether the court would have permitted such late service.

Thus, under this line of cases, the successor firm in Scenario #2 would not be a superseding intervening cause, and the predecessor counsel cannot be absolved of their liability where they represented the PI client at the time a legal right was forfeited.

Notably, while a motion to remedy a right lost dependent upon the exercise of discretion by the court and not definitive legal principles appears comparable to an appeal, the two are distinguished. Appeals are typically made upon what can only be described as judicial error (i.e. mistake of law or mistake of fact). In these scenarios, an objective court can determine definitively whether an appeal would have been successful or not. Thus, a legal malpractice action against an attorney for failing to pursue an appeal may exist if it can be shown that the appeal was “likely to succeed,” a standard adopted by many states including New York in 2014 in the matter of *Grace v. Law*. Conversely, a motion asking the court for leave to remedy a lost right involves no judicial error and only the error of the party who allowed the right to be lost in the first instance. Additionally, many jurisdictions, including the District of Columbia, Colorado, Utah, and North Carolina, just to name a few, have expressly held that a successor counsel owes no duty to the client to take action that would lessen the damages resulting from the prior counsel’s negligence, and is further not liable for contribution to the prior counsel.

This line of reasoning is consistent with the principle that a predecessor counsel is not entitled to be absolved of liability simply by the termination of their representation and retention of successor counsel.

Notably, the above analysis does not even begin to broach the fact that an attorney’s duty of care is not limited to filing a timely action. Professionals in our field owe a duty in the profession to exercise such care, skill, prudence, diligence, etc. as is commonly possessed by an ordinary member of the profession. The New Jersey Appellate Division has expressly held that a lawyer’s duty goes beyond timely commencement of an action, but also “dictated that he take ordinary precautions to protect his clients’ interest.”
“not delay filing suit until the eleventh hour,” and “inform his clients of his failure to act (for whatever cause) at a time sufficiently prior to the running of the statute of limitations to permit plaintiffs to engage another attorney who could then take proper action on their behalf.”15

So here, the question then becomes whether Firm A owes a duty to the PI client and Firm B to inform each of the failure to timely file a notice of claim. And, if so, does ignorance actually mean bliss? Can Firm A justify being absolved of liability if they did not actually know that they blew a deadline, but should have known and thus informed the PI client and Firm B of the missed deadline?

In view of the relevant case law, it seems that predecessor counsel will not successfully be absolved of liability by retention of a successor counsel in circumstances where a legal right was forfeited against at least one party (causing the alleged damages) during the time of predecessor counsel’s representation, even if a successor counsel had an opportunity to attempt to rectify the shortfalls of prior counsel. Thus, plaintiffs’ counsel handling matters that tend to require prerequisites prior to the expiration of the statute of limitations should be mindful of potential deadlines and exercise the utmost diligence to ensure that all required parties are in the action or on notice of a claim prior to the expiration of the first time limitation, even when the statute of limitations has not yet elapsed. Moreover, while being terminated as counsel may leave you with a bad taste in your mouth, it does not eliminate your obligation to exercise care, skill, prudence, and diligence in transferring the file, which may include a duty to apprise successor counsel of potential issues.

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End Notes

2 Id.
3 Stekete v. Lintz, Williams & Rothberg, 38 Cal. 3d 46, 57, 694 P.2d 1153, 1159 (1985)
5 Glamm v. Allen, 57 N.Y.2d 87, n. 2 (1982)
6 Id.
8 Grace v. Law, 24 N.Y.3d 203 (2014)
10 Stone v. Satriana, 41 P.3d 705, 712 (Colo. 2002) (holding “there is no legal duty for a legal malpractice plaintiff’s counsel to ameliorate the injury effected by predecessor counsel”)
11 Hughes v. Housey, 599 P.2d 1250, 1254 (Utah 1979) (holding “no duty should be imposed on succeeding legal counsel in favor of a preceding counsel”)
12 Shealy v. Lunsford, 355 F. Supp. 2d 820, 827-28 (M.D.N.C. 2005) (holding that “where an injury is already complete, such as through the granting of a final default judgment, it cannot be that subsequent actions by the successor attorney that did not increase the amount of the final judgment against the client, “united[ed] in causing a single injury”)
13 See, e.g., Cline v. Watkins, 66 Cal. App. 3d 174, 180 (Ct. App. 1977) (holding the retention of new counsel is not so “exceptional” so as to warrant a shifting of the duty to prevent harm).

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