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## FLASH REPORT: 2018 YEAR-END SUMMARY

*Insights about 2018 securities class action activities and developments and their relationship to historical trends—sourced from DataBox, our proprietary repository of over 30 years of data. DataBox powers our analysis of relevant information that gives our clients an accurate view of the D&O litigation environment for the assessment and mitigation of their management liability risks.*

# Another Record Year for Securities Class Actions

In 2018, 217 securities class action suits were filed<sup>1</sup>, nudging past 2017's total of 216 cases by one case. 2018 has the distinction of being the year with the highest number of filings in the last 20-year period (excluding IPO allocation cases). An average of 18.1 cases were filed per month—close to one filing per business day (0.9 cases per day).

Securities class action suits filed



## The More Things Stay the Same, the More They Change?

While we know that certain types of companies, such as technology companies or IPO companies, are more likely to be sued, the data for 2018 suggests a much more nuanced view of what is happening in the world of securities class actions. Looking at those companies that were sued in 2018 and why, a picture emerges with the following characteristics:

- Broader diversity across age and size of companies (with a shift in size over time)
- No significant movements in industry type (But a 10-year lookback is worth noting for one industry.)
- Suits against foreign companies remain steady
- Events that have been the subject of media attention over the last few years are now showing up in securities class action suits.

A review of the data gives further details:

## Trading on US Exchanges—Age Did Not Matter

Approximately one-third of the 2018 cases were brought against public companies that have been trading on the US exchanges for a short amount of time (0–5 years), and one-third were brought against companies that have been trading for more than 20 years.

Trading Time Period	< 5 years 2014–2018	5–10 years 2009–2013	> 10 years 1999–2008	> 20 years 1962–1999
% of Cases	33.2%	15.7%	19.4%	31.8%

There was an approximately 50/50 split between companies trading 0–10 years versus over 10 years:

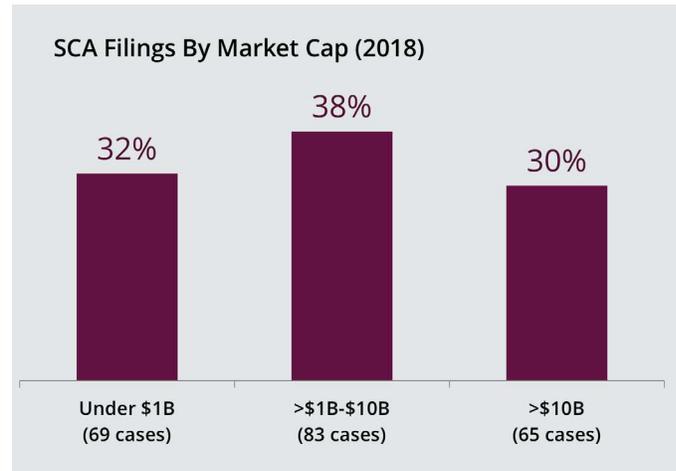
Time Period	Calendar Years	% of Cases
0 - 10 years	2009 to 2018	48.8%
Over 10 Years	1962 to 2008	51.2%

<sup>1</sup> For purposes of tracking issuer-related securities litigation, the D&O Databox focuses exclusively on securities class action lawsuits against public companies by holders of common or preferred stock for which there was a decline in stock price.

## By Market Capitalization, There Were No Clear Favorites

There was a fairly close distribution in 2018 across small-, mid-, and large-cap companies as set forth below.

The biggest movements were in the small-cap and large-cap companies. The percentage of cases filed against smaller companies was well below the 10-year average of 49%, for a total of 32% in 2018. By contrast, the percentage of cases filed against larger companies was much greater than the 10-year average of 18% for a total of 30% in 2018.



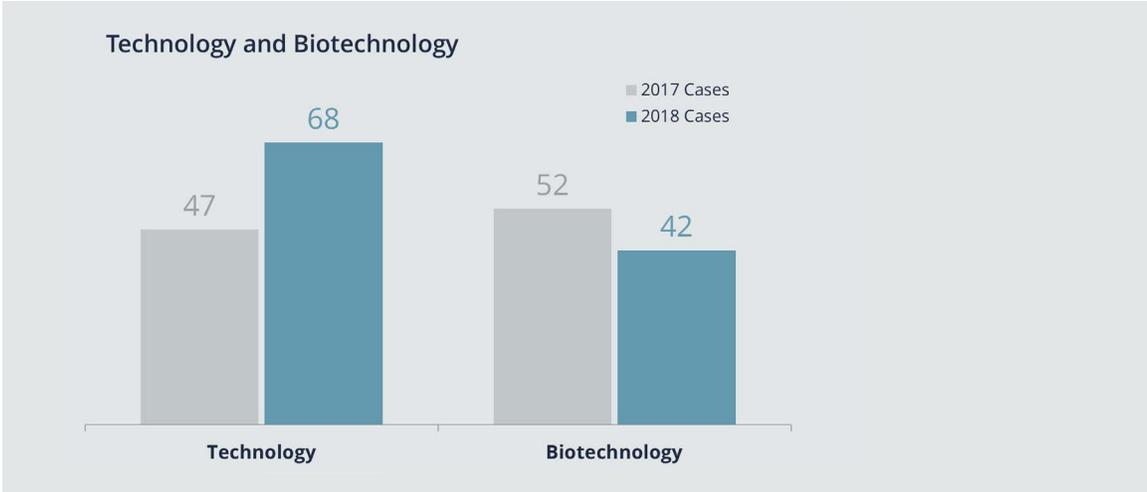
A further review of companies sued over the past 10-year period indicates that the percentage of annual filings against small cap companies was dropping, while filings have increased against large-cap companies, particularly in the last five years. Cases against mid-cap companies have remained for the most part in the 30%–40% range annually.

### Last 10-Year Period: Small-cap decreased, Large-cap increased

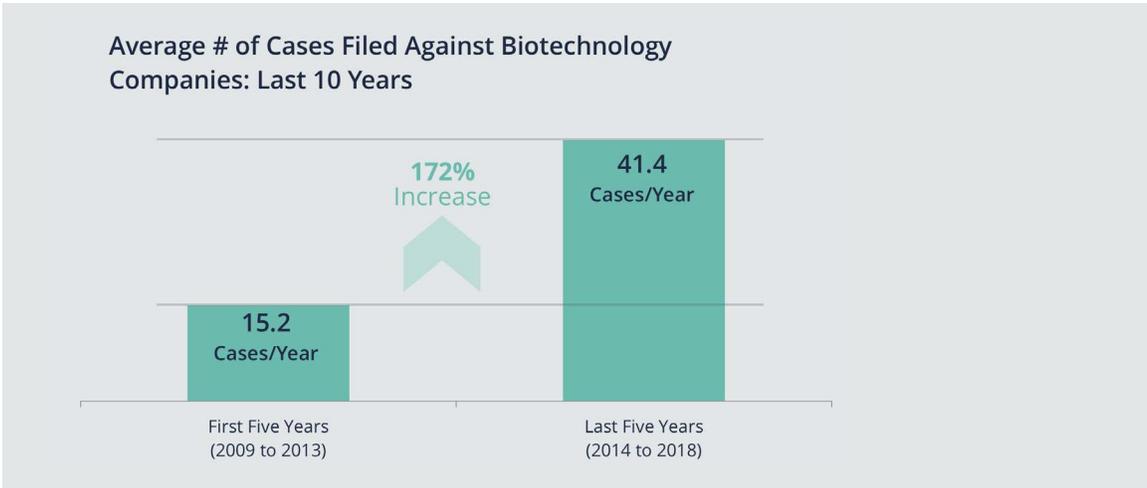


## By Industry, Technology Reclaims First Place, but . . .

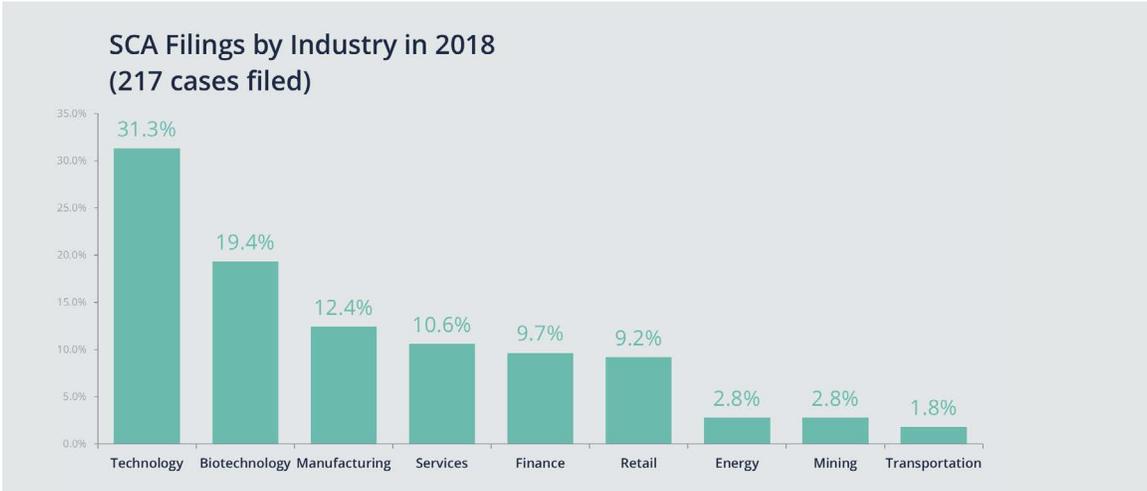
No surprises here: Cases against technology companies led the pack. In 2017, they had moved down to second in ranking, while cases against biotechnology companies took first place—a first for biotechnology cases.



Despite ranking second in 2018, cases against biotechnology companies comprised nearly 20% of 2018 cases. Both of these industries comprise a significant portion of cases filed, but cases filed against biotechnology companies saw the most dramatic shift in filings in the last 10 years—a 172% increase in filings when comparing the first five years with the following five years:



All other industries saw a 1%–2% change in movement from 2017. The following is a breakdown by percentage of all cases filed by industry in 2018:



## Foreign Companies Are Nearly a Quarter of All Sued in 2018

Cases against foreign companies accounted for 22% of 2018 cases filed. There were a total of 47 cases filed against foreign companies—17 of them against companies based in China, with the remainder headquartered in countries all over the globe:

- **The Americas:** Argentina, Brazil, Canada, and Mexico
- **Asia Pacific:** Japan and Singapore
- **Europe:** Germany, Greece, Ireland, Sweden, Switzerland, and the United Kingdom
- **Middle East and Africa:** Israel and South Africa

As of the end of 2018, approximately 20% of the companies listed on the NASDAQ and NYSE exchanges were headquartered outside of the US. Of those 20% listed, 4.5% of foreign filers listed on these two exchanges were sued in 2018.

## New Developments in 2018

### The #MeToo Movement

While the #MeToo movement has been widely reported on in recent years, the impact of sexual harassment and assault issues became a reality for several companies in 2018. Compared to the one to two cases filed since 2016, including the notable Signet Jewelers headline case, five companies were sued in 2018 by shareholders over allegations of sexual misconduct by senior management:

- CBS Corporation
- National Beverage Corp.
- Papa John's International
- Teladoc Health
- Wynn Resorts

Several of these suits allege a pattern of undisclosed serial misconduct that dates back many years and even decades. The #MeToo movement continues to be a force for change which means there will likely be more securities class action lawsuits in the future.

### Cyber Security/Data Privacy Drive Twice as Many Suits

Prior to 2018, cyber security and data privacy issues rarely impacted a company's stock price. Companies with cyber security issues experienced other types of lawsuits, such as consumer class actions or breach of fiduciary suits against directors and officers. In 2017, shareholder plaintiffs filed three securities class action cases. Two of these cases were Equifax and PayPal. The third case was filed against Yahoo! in 2017 for massive cyber security breaches from 2013 to 2016 that affected up to

three billion users, and was settled a year later for \$80 million. In contrast, 2018 saw double the number of securities class action filings related to cyber security compared to 2017, including the following six companies:

<b>Alphabet, Inc.</b> Parent company of Google	Software glitch that gave third-party app developers access to the private profile data of 500,000 users of its Google Plus social media site
<b>Chegg, Inc.</b> Educational services	Cybersecurity breach of its database that hosts user data that impacted approximately 40M users
<b>Facebook, Inc.</b> Social media and networking	Transfer of user data to Cambridge Analytica and third party cyberattack that exploited a vulnerability in its code
<b>Huazhu Group Ltd.</b> Chinese hotel management	Cybersecurity breach that involved 500M pieces of customer information being posted on the dark web
<b>Marriott International, Inc.</b> Global hotel chain	Cybersecurity breach of its Starwood guest reservation database that impacted approximately 500M guests
<b>Qudian Inc.</b> Chinese microlender	Alleged leak of data of more than a million students who had applied for loans

As technology continues to be an even more critical component for companies to compete and succeed in their respective industries on a national and global basis, cyber security, and data privacy issues will inevitably affect more companies and their shareholders. This is a trend that is here to stay.

## Section 11 Cases and the Impact of *Cyan*

In March 2018, the much-awaited Supreme Court decision came down on *Cyan, Inc. v. Beaver County Employees Retirement Fund* in favor of the plaintiffs. To recap, the federal district courts split on the interpretation of a clause in the Securities Litigation Uniform Standards Act as to whether claims that alleged a violation of Section 11 could be litigated in state courts. The Supreme Court ruled unanimously that such actions may be brought in state court and are not removable to federal court.

What have been the ramifications of this decision in 2018? In addition to the steady stream of activity in California state courts there have also been filings in the state courts of Colorado, Florida, Massachusetts, Nevada, New York, and Tennessee, for an aggregate number of 22 cases filed in 2018—a 70% increase from the previous year's 13 cases.

The number of companies that may be subject to a Section 11 suit might seem limited because the majority of the targets of such suits are companies that have gone public on the US Exchanges in the past few years. Of the approximately 825 companies that have gone public in the last five years, 6% of them have been sued for Section 11 claims in state courts, or 1% of the total population of public companies currently listed on US Exchanges (2014 through 2018). Of these companies, 84% had market caps in the \$1 billion–\$5 billion range.

## Section 11 Filings: A Bigger Universe

But there is a new twist to the types of Section 11 filings, demonstrating that this is not an IPO-only issue. Indeed, the potential universe is large. There were three companies sued in 2018 in various state courts by classes of shareholders who received company shares as the result of a merger or acquisition, only to have such share value decline subsequent to the merger/acquisition. In other words, any company could be the subject of Section 11 litigation in state courts after an M&A deal has closed. How these cases are resolved will be closely watched as they are all against mature, public companies that were involved in multi-billion dollar deals. The logic of *Cyan* would apply to registered debt offerings as well.

## Section 11 Filings: Larger Settlements in 2018

There have also been several large settlements in 2018 in California state courts. Prior to 2018, 80% of all settlements were under \$10 million, with the largest settlement in state courts for a security class action being in 2016 for \$18.6 million by King Digital Entertainment. By contrast, in 2018 four of the six cases settled for over \$10 million, moving the dial up on the size of the exposures:

- **Alibaba Group Holding Limited:** \$75M (\$21.8B offering in Sept 2014)
- **LendingClub Corporation:** \$45M (\$870M offering in Dec 2014)
- **Sunrun, Inc.:** \$32M (\$251M offering in Aug 2015)
- **Cyan, Inc.:** \$15M (\$88M offering in May 2013)

The broadened scope of activity and high settlements in 2018 suggest that Section 11 lawsuits in state courts should not be underestimated in terms of growing costs to both insurers and the insured.

## Settlement Activity: Big Losses Back in the Picture

While 2017 saw a drop in aggregate dollar amount for settlements, 2018 returned to large settlement amounts, pushing the aggregate dollar totals back up to pre-2017 levels. Excluding a \$3.3 billion settlement by Petrobras, there were a total of 80 settlements for an aggregate settlement amount of \$2.4 billion (as compared to 2017 of \$1.4 billion). Below are the median and average settlement amounts for 2018 as compared to the 10-year average:

The 2018 median settlement amount is notable for being the highest in the past decade and for topping the 10-year average. This can be attributed in part to the percentage of settlements below \$20 million dropping to 70%, below the 10-year average

2018 Median Settlement Highest in Past Decade		
	Median*	Average*
2018	\$11.0M	\$29.0M
10-Year Average	\$7.9M	\$29.1M

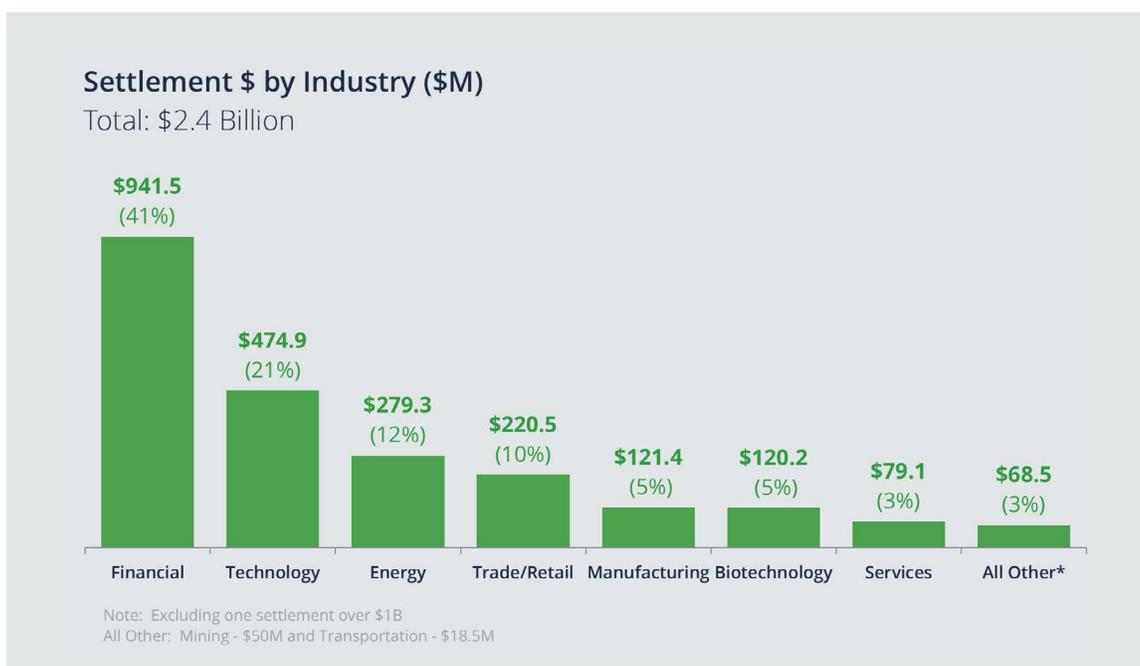
\*Excluding settlements over \$1B.

<sup>2</sup> *A New Twist in M&A Litigation: Section 11 Cases in State Court, The D&O Notebook, November 13, 2018*

of 75%, while settlements in the \$20 million–\$50 million range were at a high of 22% as compared to the 10-year average of 13%. The table to the right is a breakdown of 2018 settlements by dollar ranges:

2018 Settlement Ranges (excluding one settlement of \$3.3B)				
	\$0-\$20M	>\$20M-\$50M	>\$50M-\$100M	Over \$100M
Total \$	\$420.6M	\$595.2M	\$214.5M	\$1.1B
% of Cases	70%	22%	4%	5%

Which industries paid out the most settlement dollars in 2018? The finance industry is back in first place, technology in second, and energy in third. Settlement dollars by industry were as follows:



## Biotech Company Settlements Over the Past Decade

While biotechnology dropped to sixth place in 2018, it is worth looking further at the settlement trends for cases filed against biotechnology companies in the last decade, particularly for companies with market caps under and over \$10 billion. Of the \$1 billion of \$3.3 billion paid out in the past 10 years by small- to mid-cap biotechnology companies of under \$10 billion, the majority of these total settlement dollars, 75%, was from cases that settled in the last five years (\$751 million of \$1 billion). As the insurance market bears out, these numbers have put significant pressure on underwriters to take a much more critical look at coverage for biotechnology companies of a certain size. The remainder of the settlement dollars that were paid out in the last decade were by big pharma companies and totaled \$2.3 billion (85% with over \$30 billion in market cap).

**75%**  
of the settlement dollars from biotech companies under \$10 billion in size were paid out in the last 5 years

## A Look at Where Majority of Settlements Were Paid Out

To get a sense of the magnitude of settlement dollars paid out for securities class actions in the last decade, an aggregate amount of \$21.4 billion went towards securities class action settlements (excluding three settlements over \$1 billion). The majority of these settlement dollars were paid out in the following industries:

**Top Three Industries for Settlement Dollars** in the Past Decade

	Market Cap Ranges			Total by Industry	% of Total \$
	\$0 to \$1B	>\$1B to \$10B	Over \$10B		
<b>Finance</b>	\$511M	<b>\$2.3B</b>	<b>\$6.0B</b>	<b>\$8.8B</b>	41%
<b>Technology</b>	<b>\$702M</b>	\$1.9B	\$1.7B	\$4.3B	20%
<b>Biotechnology</b>	\$412M	\$619M	\$2.3B	\$3.3B	15%
<b>Total by Market Cap Range:</b>	\$1.6B	\$4.8B	\$10B	\$16.4B	76%

Note: Excludes three settlements over \$1 billion totaling \$6.8 billion

There are approximately 500 active cases that have yet to be resolved. Over the past 10 years, approximately 45% of cases have been dismissed and 55% settled. Factoring in the 10-year average settlement amount of \$29.1 million per case, there could potentially be up to \$8.0 billion paid out in the next 3–5 years for currently active cases (95% of them having been filed in the last five years).

\$28.2 billion dollars  
paid out over the last  
10 years—approximately  
\$2.8 billion per year.

The data broadly illustrates the enormity of the costs incurred by defendants for settlements alone. Frequency and severity of losses are further impacted when taking into account the bigger picture of director and officer liabilities for other types of exposures, such as derivative suits, M&A suits, regulatory investigations, and defense costs, along with emerging risks of cyber attacks and sexual misconduct revelations.

As costs have been going up, it appears that the insurers face challenges of their own to cover these losses. An article published by Insurance Business in November 2018 reported on an analysis put out by the leading international reinsurer *TransRe*, which indicates that while loss ratios have spiked from 2013 onward, total premium in the past four years has been stagnant.<sup>3</sup> The article highlights how insurance industry supply, plaintiffs firms, emerging risks, and insureds' spending have contributed to the current deficiency in the pool of premiums to cover risks, and that insurers have been taking corrective action via pricing.

<sup>3</sup>D&O Insurance Can't Stay This Cheap as Assumed Risks Outpace Premiums - *TransRe*, *Insurance Business*, November 13, 2018

To quote from the article:

When asked how much correction is needed, [Brian] Finlay [of TransRe] responded: If you correctly account for the prolonged price deterioration and nominal loss cost trend, at minimum 35% to 40% across the public D&O portfolio.

## Main Trends Summary

The major takeaways from 2018 are:

- Filing activity has not abated and has generally affected companies across all categories regardless of size, age, or type.
- Large settlement dollars are still being paid out despite a dip in 2017.
- Meanwhile, companies, directors, officers, and insurers are all working towards responding to their appropriate needs in this dynamic environment in order to effectively cover the risks.

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