

January 2004

2003's Top 10 Management Liability Decisions and Settlements on Liability and Coverage

While "Top 10" lists are ubiquitous at the turn of every year, we thought it might be useful to discuss the key decisions and settlements of 2003, and decided to focus our review on those actions that are likely to have the greatest impact on management liability in 2004. Other cases may involve larger dollar amounts, but we believe these 10 may have the broadest repercussions. We follow each summary with an indication of which aspect of management liability will be most affected.

Decisions

1. Adelphia: The latest decision from the bankruptcy judge in the Adelphia Communications case is that the company's D&O insurers should not be permitted to rescind their policies due to concerns about the potential impact that this could have on the company's reorganization efforts. This demonstrates the substantial impact that bankruptcy can have on contract and coverage rights. **[Impact: Insurance Coverage]**

2. Campbell: In the most recent decision from the US Supreme Court on the reasonableness of punitive damage awards, the Court held that few awards significantly exceeding a single-digit ratio between punitive and compensatory damages would satisfy due process requirements. This case has already been cited in a number of other actions. In some instances the punitive damage award was reduced; in others, efforts have begun to trigger the exceptions to the rule that were acknowledged by the Court. **[Impact: Liability]**

3. Credit Suisse First Boston: The court ruled swiftly against CSFB in the investment banking firm's coverage suit to apply the proceeds of its Errors & Omissions policy to cover its \$100 million payment arising out of a global regulatory settlement with a number of investment banking firms. The court held that a \$70 million portion of the settlement - labeled as disgorgement of monies to the SEC and NASD who had accused them of abusive

practices on IPOs – was not covered loss. The court reasoned that the E&O payment would "negate the remedial effect of a settlement if the party that had to give back the disgorgement money is repaid by an insurer." **[Impact: Insurance Coverage]**

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4. Enron: Breach of fiduciary duty claims were brought by participants in two of Enron's pension plans accusing certain company executives and the bank trustee. The court ruled that the ERISA suit could continue against several executives and the bank trustee on the theory that the executives were acting as ERISA plan fiduciaries and that the bank should have made sure that the administrator's decisions were prudent. This verdict may be a loud wakeup call for executives and may prompt bank trustees to consider new risk management strategies in order to avoid new fiduciary liabilities under ERISA.

[Impact: ERISA Fiduciary]

5. IBM: In a case currently on appeal, a district court ruled that the cash balance formula used by the company's pension plans illegally discriminated against older workers. Almost at the same time, a court of appeals in another circuit ruled that participants who received lump sums under Xerox's cash balance formula were underpaid. Wary of concluding broadly that some cash balance plans may be inherently discriminatory, fiduciaries will watch this appeal closely. **[Impact: ERISA Fiduciary]**

6. Walt Disney: In a surprise ruling, the Delaware Chancery Court stripped the independent directors sitting on Walt Disney's compensation committee of the protections typically afforded directors under the business judgment rule as well as of any corporate indemnification in a shareholder claim as to the reasonableness of a \$140 million compensation agreement with a former executive. The case is now before the lower court.

[Impact: D&O]

Settlements

7. DaimlerChrysler: The company agreed to pay \$300 million to settle claims brought by four institutional pension funds, all former Chrysler Corp. shareholders who exchanged their shares for shares of DaimlerChrysler in connection with a 1998 merger. The shareholders alleged that the company and certain senior executives had assured the markets that the transaction would be a "merger of equals" resulting in a new company in which each would be equal in power, management and governance at the senior corporate level. They further alleged that after the merger, the German company took control of the combined company, with the result that the stock price dropped dramatically, further magnifying the inadequacy of the purchase price paid for acquiring their shares. Additional suits from other Chrysler shareholders continue. **[Impact: D&O]**

8. Investment Analysts Claims: A \$1.4 billion settlement occurred between the SEC, the New York State Attorney General and 10 investment banking firms who were accused of misleading investors with stock research allegedly skewed as the result of influence exerted by the firms' banking divisions. Similar conflict of interest issues are now being reviewed globally by various international securities regulators. **[Impact: E&O]**

9. IPO Laddering Claims: A group of D&O underwriters agreed to pay \$1 billion to settle a wave of lawsuits and shareholder claims against roughly 300 companies whose shares had been taken public. While the claims focused on how certain investment bankers allocated shares in these IPOs to their preferred investors, the companies and their executives were also defendants in these suits. With this settlement, they are released from further action, while the suits continue against the investment banks. **[Impact: D&O/E&O]**

10. Putnam: While a civil penalty and other monetary relief have yet to be determined in this case, the recent, swift settlement between the investment adviser and the SEC of allegations of market-timing trades (following a comparable settlement with Canary Capital) clearly signaled the potential seriousness of ongoing probes into mutual and hedge fund practices. It can also be viewed as another example of how significant E&O or professional liability claims can spill over and result in equally weighty D&O claims. **[Impact: E&O/D&O]**