Directors and officers liability report 2023

Trends and future risks

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Kennedys

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Foreword

The global risks to directors and officers (D&O) continue to gather pace, meaning D&O insurers must continue to operate in a fast-evolving claims environment. Many of the trends affecting D&O insurance in recent years remain relevant – despite the speed at which world events are moving.

Insolvency remains a significant concern and we will see more insolvencies in 2023 emanating from a volatile geopolitical landscape that offers rising inflation, increased energy costs and ongoing supply chain issues.

The associated risks with SPAC litigation activity continue and D&O insurers will be watching for the new type of breach of fiduciary duty actions. Class actions represent a notable risk trend and despite the differences in global litigation environments, this type of litigation once dominated by the US courts is now a concern for D&Os in other jurisdictions including the UK, Australia and across Europe.

> Disruptive technology continues to exert its influence on the risk and regulatory landscape. While there are gains to be made, cyber attacks and data breaches remain areas of high risk exposure; ongoing policy reform can be expected in this space that seeks to strike a balance between enabling innovation while protecting the consumer.

In addition, the exposures associated with environmental, social and governance (ESG) present an important concern for the industry as a whole. ESG litigation continues to gain momentum, especially in relation to climate change; some of which attracts litigation funding. The risks attached to such actions encompass both financial and reputational consequences.

Accepting that society's demands on corporations to address climate change are unlikely to wane, firms will be mindful that global regulators will be eager to find new ways to enhance climate governance. D&O insurers should, therefore, take the opportunity themselves to act as ESG monitors in their own right.

This report examines the global risks to D&O insurers related to these key trends, including the relevant regulatory and legislative developments to watch.

Environmental, social and governance (ESG)

The UN's Intergovernmental Panel on Climate Change (IPCC) sixth report published in March 2023 reported that, globally, we are no longer on track to limit global warming to the landmark 1.5C temperature target by 2050. A more concerted effort from global governments to achieve net zero is now required.

This stark message is reflected in the significant increase in global regulatory intervention in the ESG space that we have seen and will continue to see throughout 2023 as the drive for transparency, clarity and consistency needed to achieve net zero gathers pace. As well as climate related activity, we anticipate seeing an escalating focus on social issues such as consumer protection, data privacy and diversity, equity and inclusion (DEI).

For example, in 2021, the US Securities Exchange Commission, the US government body designed to protect investors (SEC) announced the creation of a Climate and ESG Task Force (the Task Force) to develop initiatives and identify ESG-related misconduct. In 2023, the SEC announced that the Task Force is using data analysis to assess information and identify potential misstatements related to climate risks, as well as disclosures related to ESG. Some of the SEC's recent activity with regard to these investigations is discussed in more detail below.

Overall, the march to instil responsible business practices and embed sustainability targets into corporate governance will accelerate, and D&O insurers will need to keep up and adapt where necessary to the new risks that will emerge.

Effective, technology-driven stress testing of products, and financial reporting and procedures in relation to ESG standards, will be essential to help insurers and their customers mitigate against ESG related impacts. Here, we focus on the top trends within the environmental (E), social (S) and governance (G) space.

‘E’ | Greenwashing

The number of global climate litigation cases has more than doubled since 2015 to over 2,000, with a quarter of these claims being brought between 2020 and 2022. Compensation is often sought from company directors, with the losses falling on D&O insurers. A growing number of cases have been based on greenwashing - the suggestion that a business has made misleading or false claims when describing the positive environmental impact of its products, services or brand.

For D&Os, greenwashing falls into two categories of misrepresentations: (a) corporate, regulatory and statutory obligations (such as the UK Companies Act) and; (b) disclosure of climate change investments and related financial risks. To gain market share or enhance reputation, companies can be tempted to go over and above current regulatory and statutory obligations when providing details around their ESG credentials, or inadvertently make inaccurate disclosures. This is understandable given the consumer pressure on businesses to demonstrate a positive environmental impact.

This has resulted in the number of greenwashing claims - particularly against energy companies – continuing to rise.

Case study

The latest claim against Shell went even further – ClientEarth, an environmental law charity and minority shareholder, filed a derivative action in the High Court of England and Wales against Shell's board of directors alleging that they failed to implement an energy transition strategy which aligns with the Paris Agreement. Shell had publicly declared that its transition plan was aligned to the Paris Agreement, which was allegedly misleading.

On 12 May 2023, the court refused ClientEarth permission to pursue the claim citing that the claimant failed to demonstrate the directors had a personal duty and had failed to implement a transition strategy aligning with the Paris Agreement. In particular, the court found that the alleged duties specific to climate change were misconceived because they would impose, on directors, specific obligations on how to manage the company. This was contrary to the principle that it is for directors themselves to determine (acting in good faith) how best to promote the success of a company for the benefit of its members as a whole, not the court. The court further held that ClientEarth failed to establish that a reasonable director would not have taken the same action as the board with regard to climate risk.

On 19 May 2023, the court granted the claimant's request that it reconsider this decision at an oral hearing. We will continue to monitor the outcome of this hearing, which will be of significant interest to D&Os and their insurers.

As demonstrated by this decision and that of *McGaughey & Davies v the Universities Superannuation Scheme* [2022] *(McGaughey*), in which the court dismissed a claim alleging climate related breaches of directors' duties, claims against directors personally are difficult to pursue.

However, collective actions remain a litigation risk to D&Os as claimants have continued to issue collective proceedings backed by litigation funders. Whilst personal actions against D&Os are tricky, defence costs and coverage investigation costs for insurers can be significant.

The claimants in *McGaughey* have since been given permission to appeal the decision which is to be heard in the Court of Appeal on 13 June 2023. As demonstrated by *McGaughey*, collective shareholder action is unlikely to go away, if there is sufficient shareholder support for the claim, which is being seen increasingly often in the UK.

Given that the UK's current environmental laws allow regulators to prosecute directors where offences by a company are committed with their consent, connivance or neglect, we could also see similar offences created for individual directors.

> As such, D&Os and their insurers should not only focus on climate governance, management and disclosure of climate risk, to minimise or avoid altogether litigation and reputational risks; they should be proactive in monitoring and dealing with these risks.

Global solutions?

The FCA, as the current Chair of the Global Financial Innovation Network (GFIN) Co-ordination Group, has launched GFIN's first Greenwashing TechSprint.

The virtual TechSprint, which launched on 5 June 2023 and will run until September 2023, will bring together 13 international regulators and interested firms "to develop a tool or solution that can help regulators and the market effectively tackle the risks of greenwashing in financial services". The GFIN also seeks to "ensure that consumers have access to 'green' or sustainable financial products and services that meet their needs and/or preferences".

'S' | The Consumer Duty

The new Financial Conduct Authority (FCA) Consumer Duty (the Duty), which will come into force on 31 July 2023, introduces a higher and more consistent standard of consumer protection for retail financial services consumers. Company boards must ensure that they have senior management oversight and accountability for the Duty which is required to be embedded within the firm. Companies will also have to ensure that their employees are putting customers' interests at the heart of the business and that they rectify and remediate where customers are not receiving good outcomes.

The Duty has a potential impact on D&O cover as senior management will be required to proactively consider the Duty and will be accountable for value assessments. Given this higher standard of consumer protection and the short timeframe for compliance, we may see an increase in regulatory investigations and notifications to insurers.

'G' | Regulatory and legislative developments

The FCA sustainability disclosure requirements

2022 saw a drive from the FCA to strengthen future sustainability disclosure requirements (SDR), with some standards potentially taking effect from as early as Q3 2023. The SDR proposals will apply to all FCA regulated firms and include:

- More mandatory disclosures.
- An anti-greenwashing rule.
- The option for firms to attach sustainable investment labels to products (if they meet the proposed criteria).

> The main aim of the proposed regulations is to combat the growing number of greenwashing claims concerning financial products, to protect consumers, and to rebuild their trust in the financial market.

The introduction of the new SDR exposes companies to increased regulatory risk; the more an entity portrays itself or its products as having impressive environmental credentials, the more it will run the risk of falling foul of the FCA's requirements and expose itself to regulatory investigations and litigation. D&O insurers should expect to see a greater number of claims under policies for the costs of responding to these investigations.

The Financial Services and Markets Bill (FS&M Bill)

The FS&M Bill is designed to give the UK the chance to create a more competitive financial services sector post-Brexit. It repeals the financial services framework inherited from the EU, offering regulators vast new powers to reform EU rules, while establishing a new secondary objective for regulators to promote "economic growth and international competitiveness".

The key measures proposed include:

- The introduction of a regulatory principle recognising the Net Zero target as set out under the Climate Change Act 2008.
- To ensure the FCA and PRA (Prudential Regulation Authority) take on a new secondary objective for medium to long-term growth and international competitiveness.
- Introducing regulatory principles for the Bank of England (BoE), including a sustainable growth principle.
- Enabling HM Treasury to make modifications in relation to protecting consumers and policy holders, or those who may become policy holders.
- Providing UK courts with the power to reverse a write-down if an insurer's financial position improves, and it is deemed able to pay a greater proportion of its debt.

As the FS&M Bill makes its way through Parliament, complaints have been raised regarding the lack of mechanisms for accountability of regulators. To combat this, the Lords have proposed a range of new scrutiny mechanisms, including a new Office for Financial Regulatory Accountability that would follow a similar model of governance to the Office for Budget Responsibility.

Additionally, the Treasury plans to amend the FS&M Bill to strengthen the role of the Financial Regulators Complaints Commissioner (FRCC) by requiring regulators to address FRCC recommendations in their annual reports. While the final position remains unclear, the government is keen for the FS&M Bill to receive Royal Assent before the summer recess.

HM Treasury's Senior Managers & Certification Regime: Call for Evidence

This call for evidence was launched alongside the FCA's, BoE's and PRA's discussion paper on the Senior Managers & Certification Regime (SM&CR) and will review operational aspects of the SM&CR.

The Treasury's call for evidence delivers on the government's commitment in the Edinburgh Reforms to launch a review into the performance, effectiveness and scope of the SM&CR. The call for evidence closed on 1 June 2023 and we await the policy response. The continued focus on the SM&CR could potentially result in new regulatory powers being granted and increased exposures for D&O insurers.

Ireland implements similar regime: The Individual Accountability Framework and The Senior Executive Accountability Regime

Legislation enacting the Individual Accountability Framework (IAF) and the Senior Executive Accountability Regime (SEAR) was signed into law on 9 March 2023, namely, the Central Bank (Individual Accountability Framework) Act 2023 (the Act). SEAR brings significant changes to the oversight of persons with decision making power in regulated financial service providers (RFSPs) in Ireland.

The IAF seeks to improve governance, performance, culture and accountability for RFSPs via the implementation of four key pillars:

1. The introduction of SEAR, requiring RFSPs to set out clearly where decision making/responsibility lies in the organisation. SEAR also creates a 'Duty of Responsibility' on senior executives to take reasonable steps to prevent the organisation committing regulatory breaches in areas in which they hold responsibility.
2. The implementation of Common Conduct Standards setting out the standards expected of all persons performing a Controlled Function (CF) or Pre-approved Controlled Function (PCF) role.
3. The introduction of an Enhanced Fitness and Probity Regime, requiring RFSPs to certify annually that executives carrying out CF or PCF roles meet fitness and probity standards. Breaches of any of these new obligations will be enforceable against the RFSP and the individual executives via the Central Bank of Ireland's (CBI) Administrative Sanctions Procedure (ASP).
4. The IAF will also introduce changes to the ASP itself. Details of these have yet to be finalised. However, of particular significance, is the removal of the "participation link" in regulatory investigations conducted by the CBI. This means that the CBI will be able to proceed directly against the individual executive or in tandem with the RFSP in respect of alleged regulatory breaches, without first having to establish that the RFSP had committed a regulatory breach in which the individual had participated (as is currently the case).

The CBI is implementing the Act on a phased basis. However, all aspects of the IAF are expected to have commenced by 1 July 2024.

The implementation of the IAF will likely bring about an increase in the exposure of individual executives, and in turn, D&O insurers, to the costs associated with CBI investigations under the ASP. D&O insurers will need to consider how best to address this likely increase in exposure, possibly through increased premium and/or the introduction of sub-limits of indemnity.

ESG spotlight on the United States

'E' | Greenwashing

In the US, the SEC is more proactively investigating the validity of representations made by companies to the public and their investors about the nature of their ESG-related investments and other public statements. For example, in 2022, the SEC fined the Bank of New York Mellon US$1.5 million for misstatements and omissions about ESG-related investments in mutual funds. It also fined Goldman Sachs US$4 million for failing to implement ESG-related investment procedures with regard to some of its mutual funds and managed accounts. It is expected that the SEC will continue to investigate these types of issues going forward, especially in light of the SEC's new climate change reporting rule, expected to be issued soon (discussed below).

With regard to ESG-related public statements, in 2022, the SEC brought charges against Brazilian mining company Vale, S.A. alleging that the company concealed safety conditions related to its dams, which caused its ESG disclosure to be false and misleading.

In March 2023, the SEC announced that it had settled the charges against Vale for US$55.9 million. In light of this activity, future additional ESG-related regulatory actions can be expected.

Additionally, it can be expected that ESG-related securities and derivative class actions arising from the repercussions of greenwashing will be filed in the US. One example of this is the securities class action filed against Enviva, a wood pellet producer, that promotes itself as an ESG company. Specifically, the plaintiffs in that case allege that Enviva's claims about the sustainability of its wood pellets are false and misleading.

'S' | Workplace-related disclosures

In February 2023, the SEC settled with Activision Blizzard for US$35 million related to charges that the company failed to maintain disclosure controls and procedures to track workplace complaints. The charges also alleged that Activision Blizzard violated whistle blower protection rules by discouraging former employees from communicating with regulators.

'G' | The SEC's upcoming climate change rule

The SEC is expected to issue its highly anticipated rule regulating climate-related disclosure in the second half of 2023. This rule will require registrants to provide certain climate-related information in their registration statements and annual reports (the Proposed Rule). The Proposed Rule has two main parts and would apply to all US public companies and foreign issuers who report to, or file registration statements with, the SEC.

1. The Proposed Rule would require a registrant to disclose certain climate-related information, including information about its climate-related risks likely to have material impacts on its business or consolidated financial statements, including the disclosure of greenhouse gas (GHG) emissions.
2. The Proposed Rule would require certain climate-related financial statement metrics and related disclosures to be included in a note to a registrant's audited financial statements. These metrics would consist of reporting on separate climate-related impacts on existing financial statement line items. This would include the oversight and governance of climate-related risks, as well as how any climate-related risks identified by the registrant will have a material impact on its business. The Proposed Rule also requires disclosures of different types of emissions, including:
    - "Scope 1" GHG emissions that arise from energy sources directly owned or controlled by the reporting company.
    - "Scope 2" GHG emissions that arise from the generation of purchased energy consumed by the reporting company.
    - "Scope 3" GHG emissions, which includes all other indirect emission sources that may arise in a company's activities (e.g. emissions arising from purchased goods or services, business travel, etc.).

> Once the Proposed Rule is adopted, compliance dates for the proposed disclosures will be rolled out depending on the size of the companies at issue. However, legal challenges are expected and this could delay or even prevent its implementation. That said, many companies in the US have already started implementing policies and procedures in order to pre-emptively comply with the rule.

Complementary regimes for Hong Kong directors

In Hong Kong, ESG disclosures by directors of listed companies are regulated under two complementary regimes: the Companies Ordinance (Cap 622) (the CO), and the Environmental, Social and Governance Reporting Guide (the Guide) issued by the Hong Kong Stock Exchange.

Pursuant to section 388 and Schedule 5 of the CO, directors must prepare an annual report, which contains a business review section that should include the company's environmental policies and performance. A director's failure to take all reasonable steps to comply may attract criminal consequences.

While the CO does not specify the aspects of environmental policies and performance to be addressed in the director's report, the Guide clarifies that its requirements should complement those under the CO in relation to the director's report.

The Guide sets out mandatory requirements and "comply or explain" provisions.

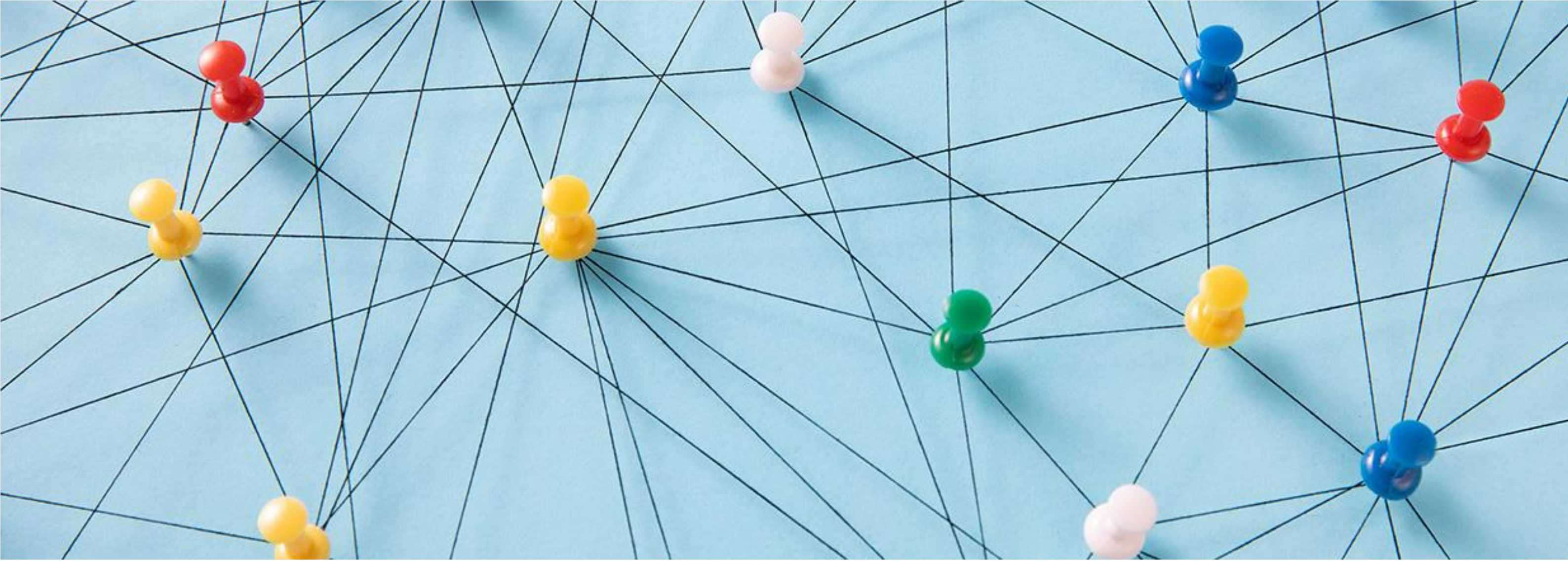
The mandatory requirements include disclosure of the board's:

- Oversight of ESG issues.
- ESG management approach and strategy.
- Review of progress made against ESG-related objectives.

As regards to the "comply or explain" provisions, directors must report on policies and compliance with relevant laws and regulations in respect of various environmental and social aspects, or explain if otherwise. For instance, environmental aspects include emissions, use of resources and climate related issues, whereas social aspects include employment and health and safety issues, supply chain management and anti-corruption policies.

The Guide imposes an overall responsibility on the board for the company's ESG strategy and reporting; if requirements are not complied with, directors may be liable to disciplinary action.

In line with the global trend of increasing disclosure obligations, the scope of a directors' duty in this regard is expected to expand within the current dual-disclosure framework.



Geopolitical risks

The impact of geopolitical risks – those risks associated with conflict or tension between countries or states – affect most lines of business, not least the D&O space. There is also a clear relationship between the geopolitical landscape and other priority topics for D&O insurers, including high inflation, ESG considerations and reputational risk.

The Russia/Ukraine conflict and cost of living crisis

More than one year on and the disruption of war continues to be a catalyst for global high inflation, rising interest rates and supply chain issues. D&O claims could be triggered by investors seeking compensation from companies that have written off Russian assets while the knock on effects of the conflict have created a heightened risk environment through sanctions, disclosures and financial market volatility.

Following the rapid demise of Silicon Valley Bank and Credit Suisse earlier this year, there are market fears that contagion and system risks could provoke similar collapses in other institutions (such as the insurance industry), despite the takeovers from HSBC and UBS respectively.

In response to the perceived financial sector fragility and the continuing cost of living crisis, the UK Government has recently published 'Mobilising Green Investment: 2023 Green Finance Strategy'. By doing so, it hopes to kill two birds with one stone: to maintain climate targets and to bring inflation down.

Insolvencies

A 2022 FCA survey confirmed an increase in the number of customers facing financial difficulties due to high inflation, rising interest rates, and supply chain issues. This perfect storm is ripe for a continued rise in corporate insolvencies across all sectors. The collapse of struggling businesses may expose shortcomings in the management of such companies. This may lead to claims by liquidators and regulators against the former directors, exposing D&O liability policies.

> To mitigate financial difficulties, increasing numbers of consumers (especially small businesses and individuals) are either reducing cover or opting out of their insurance policies altogether, leaving themselves underinsured or uninsured and exposed to both financial and claims risk.

2022 also saw the significant Supreme Court judgment of *BTI v Sequana SA and others* in which the court confirmed that directors have a duty to uphold the interests of a company's creditors when solvency is in doubt. The precise circumstances in which this special duty is triggered will be more fully developed in future cases. The relatively high threshold should discourage borderline claims, and may provide a defence depending on whether the risk of insolvency had already moved beyond probability to near-certainty. Creditor inspired claims against directors will increasingly focus on complex and costly analyses of the company's financial position, and of the precise likelihood of future insolvency, at the time of the impugned transaction.

Civil unrest

The global cost of living crisis and increased inflation has enraged a large proportion of the public, and governments across the globe are facing vocal, hostile opposition voices. Here, the UK Government's plan to bring forward the rise in the pension age (to combat current workforce shortages) has been put on hold.

Yet in France, President Macron's pension reforms sparked mass protest and national strikes, disrupting the French economy. Societal dissatisfaction can cause a rapid rise in mass movements, whether on the street or online. These tensions are leading to a shift in public sentiment against corporates and policy makers, raising the risk of populist and shareholder activism across the globe and putting D&Os' accountability under greater scrutiny.

With social media providing a platform for these voices to gather global support and momentum, we anticipate that 2023 will see a continuation of global civil unrest events giving rise to increased claims activity.

The Data Protection and Digital Information (No.2) Bill (DP&DI Bill)

The DP&DI Bill aims to reform the existing UK data protection regime following Brexit – namely the UK General Data Protection Regulation (UK GDPR) and the Data Protection Act 2018 – and will impact individuals and private and public sector companies.

The stated purpose of the DP&DI Bill is to create a new pro-growth and pro-innovation data protection framework that reduces burdens on businesses and boosts the economy. The proposed regime also aims to ensure that data can be used to empower individuals and improve their lives via more effective delivery of public healthcare, security, and government services.

A more flexible and less burdensome regime will be welcomed by UK businesses, especially SMEs and those operating in the public sector. At the same time, it will be important that the Bill does not lower data protection standards so as to affect the adequacy decision granted to the UK by the European Commission. It is hoped that the DP&DI Bill will assist D&Os to comply with their fiduciary duties, to protect the companies' financial information, and to implement protection systems accordingly.

Technology

Generate Large Language Models (GLLMs) – ChatGPT

Developed by OpenAI, GPT or Generative Pre-trained Transformer, is a large language model that adopts machine learning, a subfield of artificial intelligence (AI), and is trained to generate text. It is said to have over 175 billion machine learning parameters and is the largest of its kind.

As a result, GPT produces text that is convincing and human like, despite being predictive and relying upon statistical probability in the relevance of its output.

We must consider that GPT-3 and more latterly, GPT-4, are simply early versions of what is to come. The pace of change is likely to be quick. Any user should keep in mind that the model is still learning and unlikely to produce perfect results. Generated text often sounds professional on the surface, but its substance may be misleading or simply incorrect. It also presents the same 'black box' and bias issues as many deep neural network machine learning, making it unsuitable for many tasks. Hence the risk of claims will arise due to reliance on inaccurate ChatGPT outputs.

> Where a company has suffered loss due to reliance on inaccurate ChatGPT outputs, D&Os may face claims for breach of fiduciary duty, for example, failing to take reasonable steps to protect the company's financial information.

GLLMs also pose the risk of more sophisticated phishing attacks in financial transactions. At present, companies are trained to look for certain inconsistencies (e.g. grammatical errors) as indicators that an email or other communication might be suspicious. Threat actors could use ChatGPT to remove such indicators or 'teach' the AI-bot to write in a particular individual's style (although the technology to do so has not yet been perfected). Falling victim to a phishing attack can impact the bottom line. Where personal data is breached, the associated financial implications and costs of dealing with a cyber incident and general shareholder dissatisfaction or even third party claims will follow.

Mega litigation trends

Claims inflation

A rise in excess claims inflation is being felt by global insurers across all lines of business. For D&O insurers, a key factor driving this trend is the rising prevalence of group actions.

Group actions, or ‘class’ or ‘collective’ actions as they are often described, are procedural mechanisms that enable a group of individuals to bring claims against one or multiple defendants.

These claims are increasingly directed at companies, for example, climate related derivative claims, which is of concern to both the board and individual directors, as well as their insurers. These mechanisms, combined with the rapid increase of ESG awareness and enhanced regulatory compliance, are of key importance for D&O insurers in respect of claims inflation.

A growing trend in the UK

Whilst the UK already has established group action mechanisms in place, the following factors have arguably led to a recent rise in group litigation in the UK:

- **The growth of the third-party litigation funding (TPLF) market**.
  An increasing appetite for group litigation in the UK has been a primary factor in private investors, acting as third-party litigation funders, establishing themselves in the UK market.
- **The introduction in 2015 of a ‘collective proceedings’ regime for competition claims only**.
  This has provided a mechanism for US-style ‘opt-out’ class actions to be brought in the UK’s Competition Appeals Tribunal (CAT). This regime has captured the interest of third-party funders. Opt-out actions encompass the entire class of affected claimants unless they expressly opt-out of the action, giving rise to the potential for actions to be pursued on behalf of millions of claimants.
- **A surge in mass tort environmental claims across the globe**.
  This highlights the expanding risk of class action litigation in the environmental space, forcing companies and their investors to consider the environmental impact of existing and future product lines that are being developed abroad, as well as domestically.

Case study

Environmental class action risks are manifesting in the English courts, as exemplified in *Okpabi and others v Royal Dutch Shell Plc and another* [2021] and more recently in *Município de Mariana and Others v BHP Group PLC* [2022]. Both cases have set a trend where environmental claims are being pursued by foreign claimants seeking redress from UK parent companies in respect of the actions of their foreign subsidiaries.

The case of *Okpabi* involves an action brought by a group of more than 40,000 Nigerian claimants against Royal Dutch Shell and one of its Nigerian subsidiaries, Shell Petroleum Development Company of Nigeria Ltd (SPDC) in respect of extensive environmental damage as a result of oil spills and pollution from pipelines operated by SPDC.

Similarly, *Mariana*, concerns an action brought by over 200,000 Brazilian victims of the Fundão Dam collapse. These actions are demonstrative of the English court's willingness to entertain mass tort environmental actions. They also reflect the English court's reluctance to allow the procedural and case management difficulties that typically arise in collective actions to hinder such actions from proceeding through the English legal system.

Environmental related group litigation has advanced in a number of company business lines and we are already seeing it grow into others.

For example, in the automotive sector, numerous group actions have been pursued globally, including in the UK, against manufacturers of diesel vehicles in relation to their alleged use of defeat devices to manipulate emissions data.

These developments, in conjunction with class action developments in Europe, have prompted a greater interest in group actions against D&Os in the UK.

Class action litigation in Australia

In Australia, high-profile data breaches suffered by telecommunications provider Optus and health insurer Medibank have led to a spate of representative complaints and class action litigation.

The Australian Privacy Act (the Act) allows for individuals affected by a data breach to complain to the Office of the Australian Information Commissioner. The Act also allows for complaints on behalf of a class of affected individuals. The Commissioner has powers to investigate and make directions in relation to such a complaint. This may include orders to pay compensation or take other remedial measures. Affected individuals may then seek to enforce the Commissioner’s directions in the Federal Court.

Alternatively, affected individuals may choose to take action directly against an organisation which has suffered a data breach for breach of contract, contravention of the Australian Consumer Law, and breach of confidence.

Until recently, such actions were rare in Australia. However, the scale and severity of the data breaches suffered by Optus and Medibank (each affecting approximately 10 million current and former customers, in a nation of 25 million people) have attracted the interest of plaintiff firms. There are now representative complaints and class actions pending against both Optus and Medibank, as well as a class action by Medibank shareholders against the company alleging a failure to disclose deficiencies in its cybersecurity. If the plaintiffs are successful, data breach class actions are likely to become much more common in Australia.

‘Nuclear’ US verdicts

Excess claims inflation in the US has been driven by including the legal vehicles of class action and multidistrict litigation and the use of contingent fees to drive higher settlements. Other contributing factors include litigation funding and negative public sentiment towards businesses and corporations.

However, in the US, the greatest factor in claims inflation is the jury system and what has become known as the nuclear jury verdicts. These are verdicts that are exponentially higher than what has long been considered the value of a claim.

In the US, civil cases that go to trial are decided by juries that render verdicts on the issues of both liability and damages.

The possibility of nuclear verdicts is resulting in plaintiffs’ attorneys taking more aggressive positions on the value of cases - and D&O insurers having to consider higher settlement offers in order to avoid an excess verdict at trial.

The rise of SPACs and SPAC litigation in the US

SPACs (special purpose acquisition companies) are “blank check” companies that use money, raised in an initial public offering, to buy a company that won’t have to go through the IPO process itself. SPACs have exploded in popularity - and the lawsuits have followed.

The traditional SPAC-related lawsuit has typically flowed from a stock drop of the going-forward merged public company, including:

1. Claims under Section 11 of the Securities Act of 1933 against the SPAC directors and officers.

2. Claims under Section 10(b) of the Securities Exchange Act of 1934 against the directors and officers of the SPAC, the target company, or the going-forward merged public company.

However, there is a newer breed of SPAC-related litigation: conflict of interest-based breach of fiduciary duty lawsuits. These lawsuits do not rely on stock drops. Instead, the plaintiffs proceed on a traditional breach of fiduciary duty theory tied to alleged conflicts of interest.

> The SEC has noted that de-SPAC transactions “may give rise to liability under state law”, and that some states, including Delaware, apply both a duty of candour and fiduciary duties “more strictly in conflict of interest settings”.

Therefore, we are likely to see even more of these breach of fiduciary duty/conflict of interest complaints, fuelling this growing litigation trend. Anyone with SPAC-related exposure, including D&O insurers, should be watching closely.

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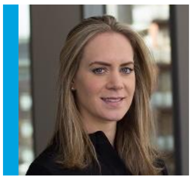

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