

CORPORATE OFFICERS & DIRECTORS LIABILITY

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VOLUME 25, ISSUE 16 / FEBRUARY 1, 2010

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REUTERS/Larry Downing

SECURITIES FRAUD

Supreme Court Seeks White House Advice On Mutual Fund Liability

The U.S. Supreme Court has asked the Obama administration to weigh in on Janus Capital Group's petition for review of a federal appeals court decision that allows shareholders to sue the mutual fund manager for allegedly helping its funds mislead investors.

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Terex Corp. Built Up Stock, Dumped Bad Fiscal News

Terex Corp. officers unloaded \$9 million of their stock before lowering the boom on investors with news that contrary to their rosy reports, the heavy-equipment manufacturer was hard-hit by the 2008 credit crisis, a shareholder's Connecticut federal court lawsuit alleges.

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Sears Investor Loses Suit Over Kmart Merger

A federal judge in Chicago has thrown out a long-standing shareholder lawsuit against Sears and its former CEO over their alleged failure to reveal merger discussions with Kmart until the deal was announced in November 2004.

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Westlaw Journal Corporate Officers & Directors Liability

Published since November 1985

Publisher: Mary Ellen Fox

Executive Editor: Jodine Mayberry

Production Coordinator: Tricia Gorman

Managing Editor: Donna M. Higgins

Editor: Frank Reynolds

Frank.Reynolds@thomsonreuters.com

Westlaw Journal Corporate Officers & Directors Liability (ISSN pending) is published biweekly by Andrews Publications, a Thomson Reuters/West business.

Andrews Publications

175 Strafford Avenue

Building 4, Suite 140

Wayne, PA 19087

877-595-0449

Fax: 800-220-1640

www.andrewsonline.com

Customer service: 800-328-4880

Subscription Rate (26 issues)

\$1,471 Print version

For more information, or to subscribe, please call 800-328-9352.

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TO OUR VALUED ANDREWS SUBSCRIBERS:

Welcome to your first issue of the new Westlaw Journal, a revised and enhanced version of the previous Andrews Litigation Reporter. We hope you are as excited to receive it as we are to present it to you.

For over 35 years, Andrews Publications has kept you informed of key court developments in your practice area, from initial filing to the resolution of a case. Our legal journalists pore over dockets, conduct extensive research and interact with the legal community to identify the cases you most need to know about. Our Expert Commentaries alert you to trends and provide you with in-depth analysis.

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In addition to all the valuable, time-saving information you had come to expect from Andrews Litigation Reporters, the new format gives you added features and expanded coverage, including: News briefs, agency reports, coverage of new and proposed legislation and regulations, in-depth commentaries from noted attorneys and professionals, verdict roundups, photos and graphics, visual aids like lists and charts to highlight key information.

Because of the new format of the Westlaw Journal, you will no longer be using three-ring binders to store your issues for future reference. With your next issue, you will receive a magazine box for easy storage and reference of your Westlaw Journal subscription.

We are thrilled to bring you this newly designed publication and would love to hear your feedback. Please feel free to contact me at Jodine.Mayberry@thomsonreuters.com.

Enjoy!

Jodine Mayberry

Executive Editor, Andrews Publications, a Thomson Reuters business

A Guide for Directors: 4 Considerations in Assessing Management's Responses to New Accounting Standards

By Barry Jay Epstein, Ph.D., CPA, and Elaine Vullmahn, CPA, CIA

Accounting specialists Barry Jay Epstein and Elaine Vullmahn of Russell Novak & Co. offer advice to directors on how to evaluate their management's response to two new accounting and reporting standards that went into effect this year.

With the arrival of the new year, managements at most affected companies are now busy implementing Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets (codified as FASB ASC 860-10-65), and SFAS No. 167, Amendments to FASB Interpretation No. 46 (codified as FASB ASC 810-10). These standards, which the Financial Accounting Standards Board published simultaneously in June 2009, make important changes to previous standards dealing with the accounting for "off balance sheet" financing and the means to avoid consolidating so-called "variable interest entities" in the sponsoring entity's financial statements.

SFAS No. 166 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (FASB ASC 860-10-05), to entirely eliminate the concept of "qualified special purpose entities," or QSPEs. SFAS No. 167 amends key provisions of FIN 46(R), Consolidation of Variable Interest Entities (FASB ASC 810-10-05), and establishes new qualitative guidance for determining when a securitization, leasing or other financing vehicle must be consolidated within the sponsor's financial statements.

Both standards were effective for the years beginning after Nov. 15, 2009, and early application was prohibited, so entities may have given little attention to the scope and impact of the changes that need to be made in their financial reporting.

THE NEW STANDARDS TAKE EFFECT

Beginning with the first quarter of 2010, the full effects of both standards will be felt for General Accepted Accounting Principles financial reporting purposes (although, thanks to action taken in mid-December by the Federal Deposit Insurance Corp., banks

and thrifts will have a phased-in application of these changes for purposes of *only* certain capital adequacy computations; this is addressed later in this article).

Because publicly reporting entities are required to give preliminary insight into the anticipated effects of adopting new, but not yet effective, financial reporting standards in their annual reports, and thus some sense of impending changes, both to the reporting entities' statements of financial position and to their tactical responses to the

behaviors, such as taking actions merely to obtain desirable accounting results, rather than true economic gains, are not tolerated.

Because implementation of SFAS Nos. 166 and 167 may prove challenging, and also because some managers may wish to evade or inappropriately react to the consequences of these changes, board and audit committee members have a heightened need to monitor progress during implementation.

The following checklist provides directors with four key questions to ask and consider

The pendulum may have swung, or was pushed, too far in the direction of limiting flexibility in the structuring of valid economic transactions.

new requirements, such indications should be provided during the upcoming annual reporting period, which will occur over the next several months, ahead of formal adoption for the first quarterly reports of 2010.

As detailed below, these *financial reporting changes* may cause some entities to undertake *operational changes* as well, notwithstanding the fact that accounting rules are designed to report economic events and transactions and are not intended to cause behavioral changes. This distinction should be understood by boards of directors, which have the fiduciary duty to ensure that all business decisions are made by management on an informed basis, in good faith and in the honest belief that actions taken are in the best interest of the company and its stockholders. That responsibility extends to gaining a sufficient understanding of these new standards to effectively supervise and direct management in their application. It also extends to ensuring that dysfunctional

when assessing how management has responded to the requirements of SFAS Nos. 166 and 167.

THE CHECKLIST

- Is management overreacting to the new rules and thus failing to exploit legitimate economic opportunities that would benefit the company?*

For many decades, off-balance-sheet securitization was viewed as an efficient and attractive financing option for entities that either purchased or generated large volumes of loans and receivables. Many companies, in industrial sectors as well as financial services, relied on this important and legitimate financial vehicle to provide needed liquidity. Failure by financial institutions to prudently use this tool, however, led investors, the Securities and Exchange Commission, and the President's Working Group on Financial Markets to demand that the FASB restrict

these then-common practices, ostensibly to improve transparency in financial reporting. These changes were promulgated as SFAS Nos. 166 and 167.

As often occurs, the pendulum may have swung, or was pushed, too far in the direction of limiting flexibility in the structuring of valid economic transactions. Indeed, some managers may have been so chastened by the imposition of these rules that even many remaining legitimate financial structuring opportunities are being voluntarily and short-sightedly forgone.

(Possibly anticipating such an undesirable consequence, the House Financial Services Committee in November accepted New Jersey Republican Scott Garrett's amendment to the Financial Stability Improvement Act, H.R. 3996, which would require that the

forgoing opportunities to achieve important financial management objectives. This mode of overreaction to the new accounting rules could lead to sub-optimal returns for the company and its shareholders. Those charged with oversight (boards and audit committees) should be alert to the need to take steps necessary to prevent this from occurring.

Is management taking affirmative steps to communicate with and educate company creditors?

Many enterprises will find that implementation of SFAS Nos. 166 and 167 will cause their statements of financial position and income to appear dramatically unlike those of prior periods, with larger amounts of on-balance-sheet debt and increased ratios

The board of directors should determine that management is making business decisions and executing business affairs with appropriate long-term goals in mind.

FASB conduct a study of the impact of SFAS Nos. 166 and 167. It would also obligate the FASB to make recommendations for further statutory or regulatory changes to ameliorate any additional negative impact brought about because of the decline in asset-backed securitizations resulting, or anticipated to result from, the new standards. Action expected by full House in 2010.)

Boards of directors should determine that management are making business decisions and executing business affairs with appropriate long-term goals in mind, rather than too narrowly focusing on achieving short-term results, such as ameliorating the adverse impact on debt-equity ratios of the new "on balance sheet" treatment of special financing vehicles by reducing profitable financing arrangements. Thus, although off-balance-sheet securitization is no longer permitted, management still have the ability to engage in so-called "on-balance-sheet securitizations," which, although lacking the financial reporting attributes formerly found to be appealing, may still offer the firm real economic benefits.

Many managers may have unfortunately become excessively wary of all securitization activities and fail to make this distinction, thus

of debt to equity. The amendments provided no grandfathering provisions for existing off-balance-sheet vehicles; all existing QSPEs must be evaluated for consolidation under the new requirements, and many or most will have to be incorporated into the sponsoring entities' financial statements.

If an entity is forced to consolidate a former QSPE, that would result in an increase in the levels of both its reportable assets and its debt. For instance, the full amounts of loans and leases (with the latter subject to a still-pending separate lease accounting project), securities, and related short-term borrowings and long-term debt will be reflected in the entity's statement of financial position.

Additionally, the consolidation mandate will likely cause many companies to true-up their allowances for loan losses and possibly to write off certain financial assets, addressing matters that were of little or no concern while off-balance-sheet treatment was being used. The addition of formerly off-balance-sheet assets and related debt will also almost universally affect the calculation of certain ratios, quite possibly with very material and inevitably negative effects.

These matters should not become a surprise to creditors. Entities should,

among other things, review whether they have debt-to-equity ratio covenants in their existing financial agreements, and quickly estimate the likely impact on those ratios of implementing the new standards. Those entities that are subject to such debt covenants, which can reasonably foresee that debt reportable in the statement of financial position will increase, may deem it advisable, or necessary, to seek adjustments to these covenants.

Even though many debt documents may not explicitly offer the opportunity for adjustments consequent to changes in U.S. GAAP accounting, many lenders may be willing to renegotiate covenants to maintain the substance of the original covenants — but only if they can be made to understand that the *apparent* change in the borrower's financial position is nothing but an accounting artifact. If appropriately and timely educated about this, lenders should be more willing to make necessary adjustments.

The board of directors should accordingly confirm that management is proactively communicating with and educating creditors about changes in the company's financial statements and to the covenant ratios based thereon. Changes in financial statement content could hamper the evaluation of credit on a historical and relative basis. It is thus imperative that management take affirmative steps and advocate for favorable terms when covenants and other debt documents are re-evaluated and renegotiated. An educated lender will probably be the company's best source for renewed or new credit.

Is management executing contracts with the same degree of care?

The new standards will not alter an entity's legal exposure in securitization or other structured financial arrangements, unless sponsors grow lax in how these transactions are constructed. SFAS No. 166 amended SFAS No. 140 (FASB ASC 860-10-05) to clarify the isolation analysis that is performed to ensure that financial assets are beyond the reach of the transferor, any of its consolidated affiliates and its creditors.

According to the revised paragraph 9, transferred financial assets are deemed to be isolated in bankruptcy or other receivership only if:

- The transferred assets would be beyond the reach of the powers of a bankruptcy

trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented. For multiple-step transfers, a bankruptcy-remote entity is not considered a consolidated affiliate for purposes of performing the isolation analysis;

- Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interest) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interest) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor;
- The transferor, its consolidated affiliates included in the financial statements being presented or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets. Examples of a transferor's effective control over the transferred financial assets include, but are not limited to:
 - (1) an agreement that both entitles and obligates the transferor to repurchase or redeem the assets before their maturity;
 - (2) an agreement that provides the transferor with both unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a cleanup call; or
 - (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them.

Boards and/or audit committees should investigate whether management is carrying out transactions in the same manner as previously executed, or whether needed changes have been made to provide equivalent protections to those previously enjoyed under now-superseded rules.

Notwithstanding the ability or inability to remove financial assets from the balance sheet, management will need to honor all contractual commitments. Contracts should continue to be effectively structured as to guarantee financial assets are isolated from bankruptcy, where that is a valid goal for the entity.

Is management assessing whether Sarbanes-Oxley controls and documentation need to be enhanced or modified?

The fate of the Sarbanes-Oxley Act of 2002 currently rests in the hands of the U.S. Supreme Court. Oral arguments were presented Dec. 7 *Free Enterprise Public Company Accounting Oversight Board*, No. 08-861, and the constitutionality of Sarbanes-Oxley has been called into question. The constitutional issues of this case center on whether the PCAOB's structure complies with the appointments clause and the doctrine of separation of powers, an issue that has arisen because PCAOB members are appointed by the SEC, not by the president, as senior officers are supposed to be.

This case is tremendously important both for the constitutional issues it raises and for the implications for future financial regulation. If the Supreme Court determines that the PCAOB's structure is unconstitutional, the entire Sarbanes-Oxley Act could also consequently have to be deemed unconstitutional and unenforceable.

The board should confirm that management is proactively communicating with and educating creditors about changes in the company's financial statements.

Until the Supreme Court reaches a decision, however, corporate managers must continue to abide by law's provisions. Even if Sarbanes-Oxley is found to be unconstitutional, the importance of internal controls over the financial reporting process has been inalterably raised in the public consciousness, and it will likely continue to receive a great deal of attention from stakeholders and independent auditors.

Therefore it is critical for managers to understand that in addition to a financial statement impact, SFAS Nos. 166 and

167 will likely affect an entity's internal operations, including those bearing upon internal controls. For instance, the manner in which data flow between different software systems should be reviewed. In addition, certain accounting applications, such as an entity's general ledger, securities and/or loan accounting applications, and debt accounting applications may require change. The process for generating interim and annual financial statements may also require alteration based on various decisions under revised U.S. GAAP.

Boards of directors should also scrutinize whether management has adequately considered the effect of fundamental internal changes on overall corporate governance. Current key and mitigating internal controls may need to be enhanced based on revised corporate communication practices, modified policies and procedures, and tailored information technology architecture. In addition, management may need to enhance or modify Sarbanes-Oxley documentation.

IS MANAGEMENT TAKING THE CORRECT COURSE OF ACTION?

It is a common reaction after the occurrence of a harmful event to want to correct the situation and prevent similar negative incidents from occurring again. Often actions are undertaken, however, before a thorough assessment and understanding of a situation have been completed. In the case of the Sarbanes-Oxley Act, it appears

Congress may have done this. The frauds and consequent collapses of Enron and WorldCom, in particular, prompted Congress to swiftly enact this law. Since its passage, many have complained that the costs of compliance far exceed the benefits to companies or the public. The Supreme Court is currently reviewing the law's language to determine whether it is constitutional (because of the structuring of the PCAOB, not because of the costs of compliance) and thus whether it should continue to be enforced.

The fate of the Sarbanes-Oxley Act currently rests in the hands of the U.S. Supreme Court.

In a somewhat similar pattern, the collapse of the residential property bubble and the resulting home mortgage crisis caused the public and various government officials to target off-balance-sheet financing vehicles and to demand that the FASB issue SFAS Nos. 166 and 167 in an expedited fashion. The primary objectives in promulgating SFAS Nos. 166 and 167 were to improve transparency in financial reporting and to provide users of the financial statements with the information necessary to evaluate the assets and liabilities of an entity that result from a creation of a securitization trust or other mechanisms to transfer financial assets and related obligations.

To achieve these goals, these standards amended existing accounting requirements to remove the concept of QSPEs from U.S. GAAP, establish new qualitative guidance for determining when a securitization vehicle must be consolidated and enhance disclosure requirements. These changes were quickly made, but some in Congress now believe that the FASB should study the combined effect of these new standards and provide recommendations for any further necessary statutory and regulatory actions. The concern is that these changes were done in haste and may negatively affect the functioning of the financial markets, with potentially far-reaching and unintended consequences for home ownership and business borrowings.

IS THE FIRM ON THE RIGHT COURSE?

Companies cannot meaningfully address these macro-economic concerns, but individual companies, and their respective

governance bodies, can and should address whether micro-level decision-making has responded inappropriately to these changes. The overarching question for boards of directors is, after SFAS Nos. 166 and 167 have been implemented, whether management is embarking upon the best course of action for the company and its shareholders. Failure to evaluate and ensure the appropriateness of management's actions could constitute a breach of fiduciary duty by the board.

Management may be inclined to limit, or even avoid, the use of securitization and other tools. Such responses could impair a company's operations and its ability to achieve optimal returns. Boards must make certain that this does not happen.

Boards of banks and thrifts must also consider regulatory capital requirements. In the abstract, ending QSPEs will likely cause large amounts of assets and related debt to be brought onto these institutions' statements of financial position. Since banks must maintain capital equal to or greater than defined percentages of assets, this accounting change can result in an institution's being transformed from well capitalized to undercapitalized status literally overnight, although nothing of substance has changed.

To partially preclude these cataclysmic developments, FDIC has announced a two-to four-quarter delay in the incorporation of formerly off-balance-sheet assets and obligations, only for purposes of calculating risk-based capital, one of the several threshold tests banks and thrifts must pass on a quarterly basis. Although providing welcome relief, the grace period will pass quickly, meaning that many financial institutions will be faced with the need to raise fresh equity capital, or to dispose of these assets and the related liabilities, in order to demonstrate capital adequacy a year from now, if not sooner. (Another test, the leverage capital ratio, is based on GAAP financial statements, and the FDIC offered

no relief from the effects of QSPE elimination for its computation.) Thus, bank boards are under even greater pressure to address the matters cited earlier in this article.

CONCLUSION

Those charged with the responsibility for governance must take positive steps to educate lenders, protect against over-reaction to the new accounting rules, and make such substantive changes as may be warranted to ensure both the entity's viability and the rationality of its ongoing management decisions, even in the face of these fundamental revisions to the financial reporting landscape. The foregoing provides a beginning framework for doing so. **WJ**



Barry Jay Epstein is partner in the Chicago accounting firm **Russell Novak & Co.**, where his practice is concentrated on technical consultations on GAAP and IFRS and as a consulting and testifying expert on civil and white-collar criminal litigation matters. He is the co-author of "Wiley GAAP 2010," "Wiley IFRS 2010" and other books. **Elaine Vullmahn** is a senior litigation accountant with the firm, specializing in internal control matters and litigation consulting.

SUBPRIME

Investor Sues Goldman Board Over \$22 Billion Executive Pay Package

A Philadelphia-based institutional investor has sued to stop Goldman Sachs' board of directors from awarding about \$22 billion, or nearly half of the investment firm's 2009 revenue, to its executives.

Southeastern Pennsylvania Transportation Authority v. Blankfein et al., No. 5215, complaint filed (Del. Ch. Jan. 19, 2010).

"The amount of compensation set aside for Goldman officers and managers bears no relation to the reasonable value of their services," the Southeastern Pennsylvania Transportation Authority says in a complaint filed in the Delaware Chancery Court.

SEPTA's suit, filed on behalf of Goldman, alleges the directors violated their fiduciary duty and wasted the company's assets by allocating about 47 percent of its 2009 net revenue to compensation.

SEPTA, a Goldman shareholder, admits in the complaint that the percentage is consistent with the firm's traditional pay practices.

As of September the Goldman board had set aside about \$17 billion for compensation, and the total is likely to exceed \$22 billion, SEPTA says.

The executives, including board Chairman and CEO Lloyd Blankfein, did little to earn their pay and benefited by simply "being there" as Goldman and the U.S. economy recover with the help of a massive government bailout, according to the complaint.

SEPTA says Goldman would have gone the way of now-bankrupt rival Lehman Bros. without a \$10 billion loan from U.S. taxpayers under the federal Troubled Asset Relief Program in 2008.

Goldman allegedly collected another \$13 billion last year from insurer AIG to settle contracts guaranteeing payment on Goldman's high-risk subprime mortgage investments. AIG in turn tapped taxpayers for the money, the complaint says.

The amount of management compensation is "unconscionable" under those circumstances, SEPTA says.



REUTERS/Brendan McDermid

"In light of the risks taken with shareholder capital and the contribution of that capital to Goldman's results, no reasonable director would approve ... almost 50 percent of net revenues as compensation," the complaint says.

SEPTA is seeking a court order requiring the directors to rescind the pay plan and to award compensation appropriate for management's efforts. [WJ](#)

Attorneys:

Plaintiff: Pamela S. Tikellis, Robert J. Kriner, Chimicles & Tikellis, Wilmington, Del.

Related Court Document:

Complaint: 2010 WL 197569

Supreme Court

CONTINUED FROM PAGE 1

Janus Capital Group Inc. et al. v. First Derivative Traders, No. 09-525, invitation to file brief entered (U.S. Jan. 11, 2010).

Janus Capital Group and its operating subsidiary Janus Capital Management LLC say the 4th U.S. Circuit Court of Appeals' decision clashes with the rulings of most other federal appeals courts.

The 4th Circuit found that the Janus companies could be liable for "helping" to produce misleading statements that the funds they administer barred "market timing" investments.

According to court records, Janus later admitted that its funds did allow market timing, which the court defined as "the practice of rapidly trading in and out of a mutual fund to take advantage of inefficiencies in the way the fund values its shares."

The Janus companies argue that they simply acted as advisers to the various mutual funds that issued the challenged statements.

They warn that if the 4th Circuit decision stands, it will be viewed as a way for shareholder plaintiffs to get around the federal rule that bars "aiding and abetting" liability for third-party advisers.

According to their petition, four federal appeals courts have ruled that "helping" another company prepare allegedly misleading statements is not a basis for liability as an issuer in a shareholder securities fraud action.

"If allowed to stand, the 4th Circuit's resolution ... would upset the securities and financial markets by exposing secondary actors to unpredictable and potentially massive liability for the misconduct of others," the petition said.

In opposition to the petition, plaintiff First Derivative Traders argues that the defendants were much more than mere "service providers" and actually administered the funds and were responsible for their "day-to-day management ... and other business affairs."

In other words, Janus executives were simply producing the statements on behalf of the various funds, the plaintiff says.

According to First Derivative, the cases the defendants cite from the appellate courts with which the 4th Circuit is in conflict involved third-party advisers who were exactly that: mere advisers.

The fact that the Supreme Court has asked for the opinion of the White House's counsel is generally regarded as an indication that it will review the appeal. **WJ**

Attorneys:

Petitioners: Mark Perry, Scott Martin, Gibson, Dunn & Crutcher, Washington

Respondents: Ira Press, Kirby McInerney LLP, New York

Related Court Documents:

Petition: 2009 WL 3614467

Response: 2009 WL 4402882

Reply: 2009 WL 4924747

See Document Section A (P. 21) for the petition, Document Section B (P. 31) for the opposition and Document Section (P. 42) C for the reply.

Terex Corp.

CONTINUED FROM PAGE 1

Glassman v. Terex Corp. et al., No. 10-70, complaint filed (D. Conn. Jan. 15, 2010).

The securities fraud suit by investor Michael Glassman alleges that top officers of the Westport, Conn.-based company built up the stock price to more than \$76 per share during 2008 by making materially misleading statements in violation of federal securities laws.

Glassman claims that throughout the year, the defendants intentionally hid reports that orders for mining and construction equipment had fallen off significantly in 2008 because of the fiscal crisis triggered by the subprime securities losses of financial services companies.

When the officers finally revealed that news in fall 2008, the company's stock price dropped by 20 percent in one day, according to the complaint filed in the U.S. District Court for the District of Connecticut.

The second shoe dropped in February 2009, when Terex revealed "dramatically" reduced

Terex officials are accused of misleading investors about:

- The decreased value of impaired assets in its construction and road-building units.
- The declining demand for equipment in its construction and materials processing units.
- The much weaker overall financials.
- Its lack of preparation for the weakening global credit market and economy.
- The lack of a reasonable basis for positive guidance regarding business prospects.

2008 revenue that dropped its stock value to \$9 per share, the suit says.

In an e-mailed comment on the litigation, **Mike Bazinet**, Terex's director of corporate communications, said the charges were "completely without merit" and that the company and the named executives "will vigorously defend against them."

"Unfortunately, these kinds of suits against corporations and top leaders are not uncommon, especially when a company sees a substantial drop in the value of its stock, as did Terex during the recent global recession," Bazinet said. "Terex has acted, and continues to act, in compliance with all federal securities laws."

In December the company announced it had sold its mining equipment division to Bucyrus International for \$1.3 billion in cash to focus on its machinery and industrial products business.

The suit seeks class-action status on claims that CEO Ronald DeFeo, CFO Phillip Widman and COO Thomas Riordan knew the bad news but violated federal securities laws by failing to use it to update their previous upbeat financial projections. **WJ**

Attorneys:

Plaintiff: David Scott, Scott & Scott, Colchester, Conn.; Joseph Guglielmo, New York; Robert Schachter, Richard Speirs and Shayne Fuchs, Zwerling, Schachter & Zwerling, New York

Related Court Document:

Complaint: 2010 WL 265876

Investors Ask Del. High Court to Reverse 'No Confidence' Ruling

Dissident shareholders of Axcelis Technologies Inc. want Delaware's highest court to overturn what they call a landmark ruling that allowed the semiconductor maker's directors to ignore a lucrative merger, the investors' vote of no confidence and their records-inspection demand.

City of Westland Police & Fire Retirement System v. Axcelis Technologies Inc., No. 594-2009, opening brief filed (Del. Jan. 4, 2010).

In an opening brief in support of their appeal, the shareholders ask the Supreme Court to reverse the dismissal of their books-and-records action and settle "two issues of vital importance to Delaware's standing as the leader in corporate law."

The plaintiffs told the high court that if the ruling by Vice Chancellor John Noble stands, it will allow directors to hide behind the business judgment rule when they thwart basic shareholder rights such as ousting unpopular directors and investigating mismanagement and disloyalty.

The business judgment rule gives the decisions of officers and directors of Delaware corporations such as Axcelis the benefit of the doubt unless there is evidence of self-interest or irresponsibility.

But the plaintiffs say rule does not apply to two of the challenged decisions in this case. The Axcelis board:

- Rejected the resignations of three directors and thereby thwarted the right of the shareholders to oust directors by withholding majority support; and
- Refused to provide the access to records of board meetings and actions guaranteed to Delaware shareholders who allege they have a proper purpose.

The issues arose after the majority of the Axcelis board spurned a 2008 merger bid by Sumitomo Heavy Industries and allegedly prevented shareholders from accepting the offer.

The dissidents organized a vote to withhold support from three of the directors on that board, and under the Axcelis charter, those directors should have been required to step down, the suit says, but the board refused



REUTERS/Ho New

to accept their resignations and thereby allowed them to stay on.

The shareholders filed a books-and-records action seeking evidence that the incumbent directors had mismanaged the company, but

The SEC "is quite aware of this case and likely quite aware of the lacuna in shareholder disclosure that it creates," law professor J. Robert Brown Jr. said.

the Chancery Court granted the company's motion to dismiss.

The vice chancellor's opinion found that the shareholders did not show a "credible basis" for the records request. *City of Westland Police & Fire Ret. Sys. v. Axcelis Techs*, No. 4473, 2009 WL 3086537 (Del. Ch. Sept. 28, 2009).

On appeal the plaintiffs argue that the judge's decision "marks a significant departure from established jurisprudence regarding shareholders' statutory inspection

rights, eliminates the opportunity for judicial review on an issue central to the shareholder franchise, and threatens to undermine Delaware's leadership role in significant issues of corporate law."

The Chancery Court wrongly applied a harsh standard of proof normally reserved for summary judgment decisions, the shareholders say.

"The Court of Chancery's analysis on this point put the proverbial cart before the horse," according to their opening brief. "The fact that directors may have discretion on an issue does not preclude an investigation under [the records inspection statute]."

If the high court affirms this interpretation of the Delaware corporate law concerning shareholder rights, the only course for investors will be "to eliminate these kinds of policies entirely, or to look elsewhere to compel directors to justify these kinds of extraordinary actions," the brief says.

Shareholder activists are lobbying the federal government to empower the Securities and Exchange Commission to force corporate boards to abide by the result of proxy actions such as the one at issue in this case.

In a recent posting on his corporate law blog *The Race to the Bottom*, law professor J. Robert Brown Jr. said the dissident Axcelis shareholders' statement was not an empty threat.

"The [Securities and Exchange] Commission, we understand, is quite aware of this case and likely quite aware of the lacuna in shareholder disclosure that it creates," Brown

wrote. "With the most recent disclosure reforms delving into board diversity and the separation of chairman/CEO, it would be eminently consistent that the SEC would undo this case." [WJ](#)

Attorneys:

Plaintiffs: Jay Eisenhofer, Michael Barry Jr. and Christian Keeney, Grant & Eisenhofer, Wilmington, Del.

Related Court Documents:

Opening brief: 2010 WL 128184

Dow Directors Not Liable for Rohm Deal

A Delaware judge has dismissed a merger challenge after finding that Dow Chemical Co.'s directors did not act irresponsibly with their \$16 billion purchase of Rohm & Haas Co. after the 2008 economic meltdown made the deal problematic.

In re Dow Chemical Co. Derivative Litigation, No. 4349, 2010 WL 66769 (Del. Ch. Jan. 11, 2010).

Chancellor William Chandler dismissed the shareholders' breach-of-duty, waste-of-assets and insider-trading lawsuit in the Delaware Chancery Court.

He found that the Dow directors made the merger agreement during the sunny sellers' market that preceded the collapse of subprime-mortgage-based securities, the credit markets and the business of both merger mates.

The decision is yet one more instance in which a shareholder challenge of ill-fated deals made before the fiscal crisis failed to penetrate Delaware's business judgment rule, which gives directors and officers the benefit of the doubt even if their decisions turn out badly.

The deference the Dow directors received made it too difficult for the shareholder plaintiffs to pass Delaware's "pre-suit" demand test.

That hurdle prevents plaintiffs from proceeding without proof that they gave their board of directors a chance to review the merit of the charges or, as was the case here, demonstrating that the majority of the board was unfit to do that because it acted selfishly or irresponsibly.

Dow first proposed acquiring competitor Rohm & Haas in 2008 but tried to back out when economic conditions quickly deteriorated.

Shortly after Dow agreed to the merger, oil and gas prices skyrocketed, a Kuwaiti state-owned company backed out of a joint venture slated to provide cash for the deal, and a Wall Street collapse triggered a worldwide recession and tightening of the credit markets.

After Rohm & Haas sued to force Dow to make good on its promise, Dow agreed on the eve of trial to go through with the union for \$16 billion, although many saw it as a bad bargain.

Dow shareholders filed suits alleging their officers and directors breached their duty to get the best deal for investors and to properly supervise the company.

The Dow directors could be considered independent and disinterested in the deal because none:

- Stood on both sides of the transaction.
- Received any extra personal financial benefit.
- Was beholden to the CEO.
- Was influenced by social and business ties.

Those suits were combined into this action, and the various defendant officers and directors asked the court to dismiss it for failure to show that pre-suit demand would have been futile.

Chancellor Chandler found that when the initial deal was struck, Dow had little choice but to agree to the seemingly extravagant terms Rohm & Haas proposed, because in that sellers' market, another suitor was likely to emerge, and the opportunity would have been lost.

The judge found no proof of any of the factors that might make the directors' judgment suspect.

The ruling gives the plaintiffs an opportunity to try again to sufficiently plead the minor charges of insider trading and waste of assets. However, the judge dismissed with prejudice the primary breach-of-duty charges.

Dow said in a statement it was "pleased" with the ruling. [WJ](#)

Attorneys:

Plaintiffs: Carmella Keener, Rosenthal, Monhait & Goddess, Wilmington, Del.; Lewis Kahn, Albert Meyers and Kevin Oufnac, Kahn Swick & Foti, New Orleans; Roy Jacobs, Roy Jacobs & Associates, New York; Laurence Paskowitz, Paskowitz & Associates, New York

Defendants: Kenneth Nachbar, Morris, Nichols, Arshat & Tunnell, Wilmington; Herbert Zarov and Michele Odorizzi, Mayer Brown, Chicago

Related Court Document:

Opinion: 2010 WL 66769



WESTLAW JOURNAL

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Sears Investor CONTINUED FROM PAGE 1

**Levie et al. v. Sears, Roebuck & Co. et al.,
No. 04-7643 (N.D. Ill., E. Div. Dec. 18, 2009).**

Granting the department store chain's motion for summary judgment, U.S. District Judge Robert Gettleman of the Northern District of Illinois said the defendants did not

merger, including that it would be acquiring the real estate or leases of about 54 Kmart stores in June 2004.

Nevertheless, it did not tell the investing public that a larger-scale transaction was in the works, according to the suit.

Sears' controlling partner, ESL Partners LP, certified to the Securities and Exchange Commission July 1, 2004, that its increasing

while Kmart's stock price rose 7.7 percent to \$109.

In a 2006 motion to dismiss, the Sears defendants asserted that they were under no duty to disclose the merger negotiations and that the complaint failed to adequately allege that either Sears or Lacy intended to deceive the investing public.

At the time, Judge Gettleman let the case proceed, saying more facts were needed before he could decide whether a reasonable investor would have considered the negotiations to be material.

But in his latest decision the judge sided with the defendants, finding that during the purported class period, "none of the factual or legal predicates" for a merger were in place.

"There were no board resolutions, no actual negotiations and no instructions to investment bankers to facilitate or explore a merger," Judge Gettleman wrote Dec. 18.

It is true that each company had raised the subject with outside advisers and that the companies' senior management held discussions about strategic combinations, he said.

But during this time a "general agreement" involving a stock-and-cash transaction was not even in place, according to Judge Gettleman. **WJ**

Related Court Document:
Opinion: 2009 WL 5096401

Sears did not tell the investing public
that a larger-scale transaction
was in the works, according to the suit.

make any material omissions or misleading statements concerning the merger.

Maurice Levie, a former Sears shareholder who sold his shares at a low price when the defendants were negotiating with Kmart, filed the lawsuit in 2004.

He asserted that anyone who owned or traded in Sears securities between Sept. 19, 2004, and Nov. 16, 2004, suffered financial losses because the defendants did not reveal the negotiations, and the price of Sears stock jumped more than 15 percent in a single day when the deal was publicized.

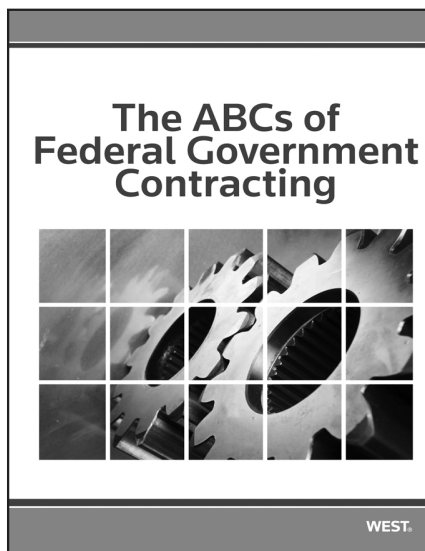
Sears allegedly made numerous statements about its business operations before the

ownership of Sears stock was not indicative of any intent to influence or change the control of the company, Levie said.

But once ESL and then-Sears CEO Alan J. Lacy started discussing a merger that could affect Sears, Levie added, they were legally required to file a revised document with the SEC.

Sears and Kmart eventually announced Nov. 17, 2004, that Kmart would acquire Sears, with Kmart stockholders receiving 55 percent of the combined companies' equity.

As a result of the announcement, Sears' stock price jumped 17 percent to \$52.91 per share,



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BREACH OF DUTY

Alcon Shareholders Sue to Stop Novartis Buyout

A charitable fund in Milwaukee has sued on behalf of all minority shareholders of Alcon Inc., claiming that they are about to get the short end of the stick in Swiss drugmaker Novartis AG's \$39 billion takeover of the eye-care specialist.

Erica P. John Fund Inc. v. Novartis AG et al., No. 10-139, complaint filed (S.D.N.Y. Jan. 7, 2010).

The suit, filed in the U.S. District Court for the Southern District of New York, alleges that Novartis is planning to use its power as the majority shareholder to squeeze out the

Novartis and Nestlé “carefully structured” the proposed deal to deprive Alcon’s minority shareholders of the true value of their stock, the complaint says.

minority shareholders in a stock-swap offer that grossly undervalues Alcon stock.

Novartis first acquired a 25 percent interest in Alcon in 2008, according to the lawsuit filed by the Erica P. John Fund.

The firm announced Jan. 4 that it would exercise its option to buy 52 percent of the Alcon shares held by Nestlé S.A. for nearly \$180 per share, boosting its overall ownership interest in Alcon to 77 percent.

According to the lawsuit, Novartis also announced that it intends to “squeeze out”

the remaining 23 percent interest in Alcon held by public minority shareholders through a stock-swap offer of 2.8 shares of Novartis stock.

This offer grossly undervalues Alcon's stock because 2.8 shares of Novartis stock comes out to only \$145 per Alcon share, according to the complaint.

“Not only is the Novartis bid approximately \$8 less than the current trading price of Alcon shares, but it is also about \$34 less than the price that Novartis has agreed to pay Nestlé for the same class of shares,” the fund said in a statement.

The plaintiff adds that Novartis and Nestlé, which also is named as a defendant in the case, “carefully structured” the proposed transaction to deprive Alcon's minority shareholders of the true value of their stock.

The drugmaker also has made clear that it intends to remove any independent directors at Alcon who “dare oppose Novartis’ predatory conduct,” according to the lawsuit.

The fund seeks preliminary and permanent injunctions blocking the transaction because it says the minority shareholders currently stand to lose roughly \$33 per share as a result of the defendants’ “disparate, unfair and illegal treatment.” [WJ](#)

Attorneys:

Plaintiff: Lewis S. Kahn, Neil Rothstein and Albert M. Myers, Kahn Swick & Foti, New Orleans; Gerald H. Silk, Mark Lebovitch and Amy Miller, Bernstein Litowitz Berger & Grossmann, New York

Related Court Document:

Complaint: 2010 WL 110227

CRIMINAL ACTIONS/ SECURITIES FRAUD

Former Qwest Exec Loses New-Trial Motion

Newly discovered evidence presented by former top Qwest Communications exec Joseph P. Nacchio in his motion for a new criminal trial was not new and simply rehashed previous testimony, a Colorado federal judge has ruled in denying the request.

United States v. Nacchio, No. 05-CR-00545, 2010 WL 148271 (D. Colo. Jan. 12, 2010).

Nacchio had argued that a key witness at his criminal trial broke new ground to his advantage when she testified at a later civil proceeding.

However, U.S. District Judge Marcia S. Krieger of the District of Colorado saw nothing new in the civil testimony, just the same inconsistencies about Qwest's financial numbers the jury considered in the criminal trial.

In 2007 Nacchio was convicted in the District Court on 19 counts of insider trading for using nonpublic information to sell nearly \$100 million worth of Qwest stock. He was sentenced to 72 months in prison.

The Denver-based company provides local and long-distance telephone and data services.

The nonpublic information involved company reports that Qwest was not going to meet its financial earnings expectations. Nacchio allegedly made a \$52 million profit on the stock sales before the disappointing earnings were publicly announced.

There were two sets of company reports: those for the internal use of Qwest execs, and those that were to be released publicly. The public reports projected an earnings shortfall that was more than twice the figures listed

in the internal reports, according to court records.

Nacchio has argued that he was only told about the internal disclosure with a reported shortfall that was too small (\$300 million, or 1.4 percent of total revenue) for the warning to be material for securities fraud purposes.

Therefore, he said, a new trial is warranted because an insider-trading conviction requires proof he was aware of nonpublic information considered material under federal securities law.

Nacchio's motion for a new trial concerned a key witness at his criminal trial, former Qwest CFO Robin Szeliga, and her deposition testimony at a subsequent Securities and Exchange Commission proceeding. Nacchio argued that the deposition testimony exonerates him.

However, Judge Krieger noted that Szeliga's criminal trial testimony was inconsistent. The former CFO told the jury that she had warned Nacchio about the public-disclosure shortfall (\$900 million, or 4.2 percent of total revenue) but referred to it in her testimony as Qwest internal reports.

The jury voted to convict Nacchio despite the inconsistency.

The judge also said Szeliga's deposition testimony in the SEC proceeding, sprinkled with protestations of limited recollections, offered nothing new.

"Because the deposition testimony only repeats some portion of testimony already given by Ms. Szeliga, the deposition testimony does not warrant a new trial," Judge Krieger concluded.

Last fall Nacchio lost a bid to have the U.S. Supreme Court overturn his conviction on grounds that the lower courts erred by barring the testimony of his securities valuation expert at the criminal trial.

Szeliga served six months' home confinement and two years' probation for selling \$410,000 worth of Qwest stock based on the same insider information she gave Nacchio, according to Denver federal court records. [WJ](#)

Related Court Documents:

Order: 2010 WL 148271

Nacchio's motion: 2009 WL 612148

Government's response: 2009 WL 935446

D&O INSURANCE/ADVANCEMENT

Judge Says Need for Coverage Ruling Trumps Advancement Right

HLTH Corp. officers cannot force their D&O insurers to immediately pay their defense bills until the Delaware Supreme Court decides whether policy exclusions let the carriers off the hook for coverage of underlying suits, a state court judge has ruled.

HLTH Corp. et al. v. Axis Reinsurance Co. et al., No. 07C-09-102, 2010 WL 60128 (Del. Super. Ct., New Castle County Jan. 7, 2010).

Judge Richard Cooch of the New Castle County Superior Court had previously ruled that officers of the medical practice management software conglomerate had a right to advancement of their legal costs while HLTH and its insurers battled over which policies covered the underlying actions.

However, in the latest of many rulings in the multi-layered insurance coverage action, the

However, the judge ruled Jan. 7 that the public policy reasons for enforcing that right are outweighed in this case by the possibility that the state Supreme Court will reverse his decision and find no coverage available at all — including funds to pay for fee advancement.

That would mean the insurers would be irreparably damaged if they were not able to recover the money they had already advanced to the officers, Judge Cooch reasoned in granting the stay.

The case is the first to squarely address several novel questions regarding insurers' duty to advance funds while coverage is in dispute.

judge imposed a stay on the officers' effort to force some of the insurers to start advancing funds to cover their mounting lawyer bills.

The case has been closely watched by insurance and corporate law specialists because it is the first to squarely address several novel questions regarding insurers' duty to advance funds while coverage is in dispute.

INDEMNIFICATION AND ADVANCEMENT

Judge Cooch acknowledged that Delaware-chartered companies like HLTH commonly agree to pay for the defense of their officers and directors for litigation and investigations involving their corporate roles.

Moreover, Delaware companies usually guarantee that in addition to this promise of indemnification, they will reimburse their officers and directors for their legal bills as they come in rather than at the end of the litigation.

CASE HISTORY

The judge allowed HLTH and several groups of insurers to take immediate appeals of parts of two crucial rulings he made last August. *HLTH Corp. et al. v. Clarendon Nat'l Ins. Co. et al., No. 07C-09-102, 2009 WL 2849777 (Del. Super. Ct., New Castle County Aug. 31, 2009).*

Those twin rulings made preliminary findings on the applicability of two commonly used policy exclusions that could bar coverage for the alleged wrongs in the underlying litigation.

The underlying actions were based on alleged wrongdoing at one of the many companies that were created, bought and sold in a complex series of mergers, acquisitions and asset sales involving HLTH and its predecessors in a decade-long period ending in 2006.

Each of the companies that was part of the conglomerate at various times brought with it a "tower" of D&O insurers that provided primary and excess coverage.

When HLTH sought reimbursement for the mammoth legal bills its directors and officers were amassing in a federal government action slated for trial this year, all the insurers declined payment and HLTH then filed this action.

THE TWIN APPEALS

While the appeals of the judge's Aug. 31 decisions on the policy exclusions were still being briefed in the Delaware Supreme Court, HLTH asked Judge Cooch to issue an order that would enforce his ruling that some of the insurers must start paying the officers' legal bills.

When the insurers moved for a stay, HLTH argued that granting their request would effectively allow insurance companies to ignore the right of advancement by appealing any order to pay up.

However, Judge Cooch found that, as with any other interlocutory petition, the right to an appeal of a ruling on advancement is not automatic and is granted only when there is a distinct possibility of success on the merits and a threat of irreparable harm.

Here, both factors are present, the judge said, since the high court could well decide he was wrong regarding the applicability of one of the exclusions.

Moreover, the insurers might face a daunting task in attempting to recover money from officers who were hard-pressed to pay large legal bills, the judge held. [WJ](#)

Related Court Document:
Opinion: 2010 WL 60128



REUTERS/Regis Duvignau

D&O INSURANCE/EXCLUSIONS

Del. High Court to Hear Argument On D&O Insurance Exclusions

HLTH Corp. and its insurers will argue in Delaware's highest court Feb. 24 about whether "prior notice" and "prior acts" exclusions in their D&O policies bar coverage for defense of the medical practice software firm's officers in underlying lawsuits.

Axis Reinsurance Co. et al. v. HLTH Corp. et al., No. 565-2009; HLTH Corp. et al. v. Axis Reinsurance Co. et al., No. 569-2009, oral argument scheduled (Del. Feb. 24, 2010).

The Supreme Court will hear oral argument in the twin appeals of two related decisions by the state Superior Court on the validity of two common policy exclusions in a complex coverage dispute between HLTH and its insurers.

The insurers' appeal focuses on Judge Richard Cooch's decision that a "prior acts" exclusion barring claims for wrongs that occurred before the policy period began does not get the carriers off the hook simply because one or more of the wrongs alleged in the underlying actions *may* have occurred before coverage started.

HLTH won that ruling but is appealing another decision by Judge Cooch in the same case on the "prior notice" exclusion. The judge found that the company cannot claim

coverage from one group of insurers if it had already made a claim to other carriers for suits over the same wrongs.

Judge Cooch had allowed an immediate appeal of both issues because the high court's decision could settle two major issues in the case.

He also stayed HLTH's bid to force some of the insurers to pay the officers' defense bills pending the Supreme Court's ruling. *HLTH Corp. et al. v. Axis Reinsurance Co. et al.*, No. 07C-09-102, 2010 WL 60128 (Del. Super. Ct., New Castle County Jan. 7, 2010).

THE UNDERLYING SUITS

The underlying actions were based on alleged wrongdoing at one of the many companies that were created, bought and sold in a complex series of mergers, acquisitions and asset sales involving HLTH and its predecessors in a decade-long period ending in 2006.

Each of the companies that was part of the conglomerate at various times brought with it a "tower" of D&O insurers that provided primary and excess coverage.

When HLTH sought reimbursement for the mammoth legal bills its directors and officers were amassing in a federal government action slated for trial this year, all the insurers declined payment and HLTH filed suit in the Superior Court.

THE 'PRIOR ACTS' DISPUTE

A group of insurers, including National Union, Fireman's Fund Insurance Co., RSUI Indemnity, Old Republic Insurance Co. and Axis Reinsurance Co., moved for summary judgment on the prior-acts issue.

They argued that since there are well-supported charges in the underlying action that some of the wrongs occurred before the beginning of their policy periods, the prior-acts exclusion excuses them from advancing defense costs involving any of the alleged misconduct.

But Judge Cooch said the plain language of the policies does not support the narrow reading the insurers give it.

He denied the insurers' motion for dismissal and granted HLTH's motion to force some of the carriers to begin paying for defense costs as the bills came in.

National Union, Axis and other insurers appealed that ruling.

Since the loss for which HLTH seeks coverage is associated with a conspiracy that is deemed to arise from wrongful acts predating the policies' cutoff date, there can be no coverage and no obligation to advance defense costs, National Union said in a reply brief.

THE 'PRIOR NOTICE' DISPUTE

HLTH appealed Judge Cooch's decision involving the prior-notice exclusion, which

"Where, as here, the policy terms are ambiguous, Delaware law requires that the issue of coverage must be resolved in favor of the insured," HLTH Corp. argues.

bars coverage for wrongs that have already been alleged in claims for coverage under other policies.

The ruling turned on unique wording in the policies in the "tower" of insurance that Emdeon Practice Services Inc. brought with it when it joined the HLTH conglomerate.

The insurers that wrote those policies say there were no separate wrongs alleged in the underlying action that were unique to the period those policies covered.

Therefore, they say, all the claims that were made alleged wrongs that occurred and were reported to the insurers before the

2005-2006 period covered by the Emdeon policies at issue.

Judge Cooch agreed, finding that when those policies were written, the insurers did not know that claims had already been made concerning wrongs that may also have been covered by the Emdeon policies in dispute.

HLTH says the judge ignored his duty to give the company the benefit of the doubt where there is any ambiguity in the policy wording.

"Where, as here, the policy terms are ambiguous, Delaware law requires that the issue of coverage must be resolved in favor of the insured," the company said in its reply brief.

The insurers have failed to show that there are no other reasonable interpretations of the policy language regarding prior notice or show that HLTH's version is not the most likely, the company argues.

The high court commonly decides cases within three months of the oral argument date. **WJ**

Related Court Documents:

Insurers' reply brief: 2010 WL 128182
HLTH's reply brief: 2010 WL 128181

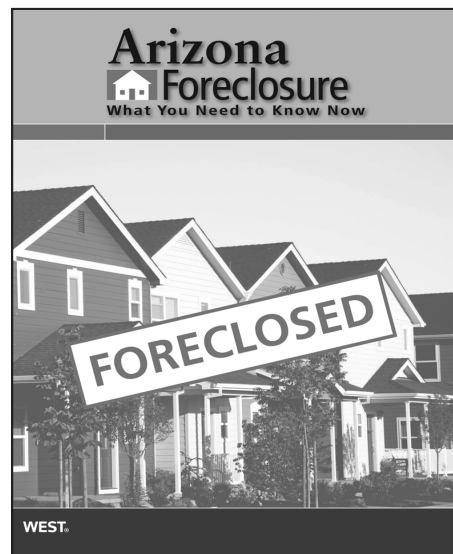
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D&O INSURANCE

Failed Bank Says D&O Insurer Cannot Reargue Coverage Ruling

A failed bank's D&O insurer cannot use its motion to amend a Kansas federal judge's judgment against it in a coverage dispute as an excuse to "rehash" its unsuccessful argument about when the policy ended, the lender contends.

Columbian Financial Corp. v. Banclnsure Inc., No. 08-2642, memorandum in opposition filed (D. Kan. Jan. 15, 2010).

Plaintiff Columbian Financial Corp., which foundered during the fiscal crisis in 2008, took that position in a memorandum opposing Banclnsure Inc.'s request for a change to a judgment in favor of the bank and one of its directors.

U.S. District Judge Carlos Murguia of the District of Kansas had ruled that while the coverage of the D&O policy ceased when federal banking regulators put Columbian in receivership, the policy itself was not terminated and the bank's receiver could continue to submit claims for coverage of prior occurrences. *Columbian Fin. Corp. v. Banclnsure Inc.*, No. 08-2642, 2009 WL 4508576 (D. Kan. Nov. 30, 2009).

THE JUDGE'S ALLEGED ERRORS

In support of its motion to alter or amend the judgment, Banclnsure argues that Judge Murguia misunderstood the meaning and effect of two key sections of the policy language. The insurer says:

- The terms "cessation of coverage" and "policy termination" mean essentially the same thing: The policy is dead. No court has ever made any distinction between those terms and allowed new claims to be filed against a policy whose coverage has ceased; and
- The regulatory exclusion in the policy meant that the policy and its coverage were terminated the day that federal regulators appointed a receiver over the bank and any claims he might make were automatically barred.

There is no additional endorsement in the policy that grants extra coverage regarding actions by receivers, Banclnsure notes.

THE BANK'S OPPOSITION

In opposition, Columbian says Banclnsure has no authority to reargue the case under the guise of a motion to amend, which, according to the bank, is reserved for contentions that new evidence has come to light or that the judge misunderstood the law or the main arguments.

The motion is based on nothing more than "Banclnsure's disagreement with the court's ruling and offers no ... claim that the court's decision reflects a manifest error of law or fact," the bank says in its memorandum.

While it may be true that the cancellation of a policy results in a cessation of coverage, the opposite is not true, Columbian contends.

As to the regulatory exclusion issue, the bank argues that coverage for acts occurring after the appointment of a receiver ceased "but the policy remained in effect and plaintiffs have a right to submit claims based upon acts occurring before the cessation of coverage."

WJ

Attorneys:

Plaintiff: Michael Thompson and Lyndsey Conrad, Husch Blackwell Sanders, Kansas City, Mo.

Defendants: Keith Witten, Gilliland & Hayes, Overland Park, Kan.

Related Court Documents:

Memorandum in support: 2009 WL 5511045
Memorandum in opposition: 2010 WL 265877

Judge Orders Firm, Insurer to Arbitrate Combo Coverage Dispute

A federal judge in Ohio has ordered Packer Thomas & Co. to arbitrate its dispute with its insurer concerning whether D&O and employment policies cover age-discrimination claims against the accounting firm and its officers.

Packer Thomas & Co. et al. v. Federal Insurance Co., No. 09-2469, 2010 WL 148140 (N.D. Ohio Jan. 12, 2010).

Judge Sara Lioi of the U.S. District Court for the Northern District of Ohio dismissed the insurance coverage action after finding that Packer Thomas and Federal Insurance Co. agreed to submit any coverage disputes to binding arbitration.

In the underlying action, a Packer employee who was fired in July 2007 brought an age-discrimination suit in Ohio state court and then sought to have the claims arbitrated.

The firm later made a defense claim to its insurer under a combination policy that provided employment, D&O and fiduciary-liability insurance.

Federal denied coverage in November 2008 on the ground that the notice was late.

Packer and some of its officers, directors and principals brought this coverage action, seeking a ruling that no basis for the denial of coverage existed because the insurer suffered no injury concerning the notice's timing.

In response to Federal's motion to dismiss the coverage suit and to compel arbitration,

Judge Lioi said the policy passes the four-part test used by federal courts in the 6th Circuit to determine whether to grant a motion to compel arbitration.

The judge noted that Federal's combination insurance package required that if the employment coverage applied, it would be used first to cover any underlying action, even if the other coverage areas (such as the D&O section) might be involved.

Since the employment insurance section required all disputes be submitted to binding arbitration, this coverage action must be arbitrated, the judge ruled.

She dismissed the suit and ordered arbitration. [WJ](#)

Attorneys:

Plaintiffs: Marshall Buck and Megan Graff, Comstock, Springer & Wilson, Youngstown, Ohio

Defendants: Karen Bonvalot and Stanley Lehman, Sherrard, German & Kelly, Pittsburgh; Michelle Sheehan, Reminger & Reminger, Cleveland

Related Court Document:

Opinion: 2010 WL 148140

IN THE NEWS

SEC FILES NEW CHARGES AGAINST BOFA

The Securities and Exchange Commission filed a second lawsuit in Manhattan federal court Jan. 12 that widens its charges of misrepresentation involving Bank of America's bailout merger with Merrill Lynch. The original complaint claimed BofA violated federal securities laws governing proxy solicitation by telling investors that Merrill would not pay any bonuses without the bank chain's approval. However, before those proxy materials were mailed, BofA's top officers already had secretly approved up to \$5.6 billion in bonuses for Merrill executives, the SEC alleges. The agency had sought permission to amend that suit with charges that BofA violated federal securities laws by hiding Merrill's "staggering" losses in fall 2008 so it could sell the merger to investors, but U.S. District Judge Jed Rakoff directed the government to put the new charges in a new suit in the same court. The SEC has again declined to sue the officers and lawyers.

Securities and Exchange Commission v. Bank of America Corp., No. 10-0215, complaint filed (S.D.N.Y. Jan. 12, 2010).

REFCO LAWYER DRAWS 7-YEAR PRISON TERM

An outside lawyer for now defunct Refco Inc. was sentenced Jan. 14 in Manhattan federal court to seven years in prison for taking part in the collapse of the former commodities trading powerhouse. Joseph P. Collins, 59, of Winnetka, Ill., was found guilty on conspiracy and two counts each of securities fraud and wire fraud following a nine-week jury trial last summer. Prosecutors said Collins allegedly helped Refco execs cook the books and hide massive commodities trading losses from investors and banks. New York-based Refco collapsed in 2005 when executives there were forced to reveal the firm was in the red by \$430 million.

United States v. Collins, No. 07-CR-01170, defendant sentenced (S.D.N.Y. Jan. 14, 2010).

INVESTORS AMEND FRAUD SUIT AGAINST WAMU

Washington Mutual Inc. sold unwitting investors more than \$31 billion worth of securities in 2006 and 2007 backed by high-risk mortgage loans, according to an amended fraud complaint filed in Seattle federal court. The class-action suit alleges WaMu, subsidiaries and top executives violated the Securities Act of 1933 by distributing misleading securities offering documents. When the truth emerged about WaMu's lax underwriting standards, the certificates fell about 40 percent in value from their offering price of \$1,000 each, the suit says. The lead plaintiff is seeking compensation on behalf of investors who relied on the offering documents in deciding to buy the certificates.

Boilermakers National Annuity Trust Fund v. WaMu Mortgage Pass Through Certificates et al., No. 09-CV-37, 2009 WL 5201702, amended complaint filed (W.D. Wash. Dec. 31, 2009).

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