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Sarbox, Dodd-Frank And Beyond

Compliance Past, Present and Future

By Scott McCleskey

When Sarbanes-Oxley was passed 10 years ago, it was difficult to envision the regulatory world we live in today. Accelerating globalization of the economy, increasing complexity of financial institutions and markets, and the global financial crisis of 2008-09 have brought us to a regulatory environment that is far broader and more complex than anyone could have foreseen at the time.

Sarbanes-Oxley ("Sarbox") was certainly a wake-up call for a lot of people. It was the beginning of a trend that accelerated following the financial crisis. It not only represented a new set of regulations, but also triggered a realization that an entirely new level of regulation, compliance and oversight was taking hold. It set the stage for new waves of regulation, including the Fair & Accurate Credit Transactions Act, the UK Bribery Act and Dodd-Frank, to name only a few.

And the pace of regulation continues to accelerate. Our analysis shows that global regulatory activity has recently been increasing by about 16% each year.

As the pace of regulatory activity is increasing, so too are the costs. And in addition to the regulations themselves, Sarbox helped usher in a whole new level of costs of compliance that needed to be accounted for.

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Patentable Subject Matter: The Controversy Continues

By David E. Mixon and Kathleen T. Milam

The patentability of business methods continues to be a hotly debated topic. Unfortunately, the release of each new court opinion only seems to further cloud the issue and add layers of confusion. In fact, many courts, including the Court of Appeals for the Federal Circuit, seem reluctant to discuss 35 U.S.C. § 101, which governs patentable subject matter. This certainly seems to be the case with the Federal Circuit's recent decision in *MySpace, Inc. v. GraphOn Corp.*, No. 2011-1149, 2012 WL 716435 (Fed. Cir. Mar. 2, 2012), which gives a good indication of how that court prefers to handle the issue, especially in light of the Supreme Court ruling in *Bilski v. Kappos*, 130 S. Ct. 3218 (2010). And, since the Supreme Court has gone on to mirror the *MySpace* decision in its own recent *Prometheus* decision, this case becomes even more significant in terms of divining which way the judicial winds are blowing on this issue. *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 132 S. Ct. 1289 (2012). Only by first understanding the current state of the judiciary can in-house counsel then develop practical plans and strategies.

Bilski: The One Test to Rule Them All? Not So Much

In an attempt to create a bright-line rule for determining the patentability of a business method, which is considered by many to be nothing more than an abstract idea, the Federal Circuit in *In re Bilski* articulated the "Machine or Transformation Test." 545 F.3d 943 (Fed. Cir. 2008). Widely familiar among patent practitioners, the Machine or Transformation Test provides that a claimed process, while otherwise an abstract idea, may still be patentable if tied to a particular machine or if an article is transformed from one state to another.

Had the Supreme Court adopted this test as a concrete rule, the debate over whether business methods are patent-eligible may have concluded with this case. Unfortunately, the *Bilski v. Kappos* Court disagreed with the Federal Circuit reasoning, stating that the Machine or Transformation Test should not be the sole test for determining patent eligibility of otherwise abstract ideas. Instead, the Court

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called the Machine or Transformation Test "an important and useful clue" in the abstract idea inquiry, in order to avoid unnecessary judicial limitations on the patent statutes. Moreover, the Court noted that if the Machine or Transformation Test was made exclusive, it might rule out emerging technologies that do not neatly fit into its required analysis.

In *Bilski*, the Court rejected the idea that business methods should be categorically excluded from patent eligibility; nevertheless, the Court provided little clarification for the practical determination of whether a business method was more than an abstract idea. As a result, the *Bilski* decision left in its wake a plethora of discrepancies and inconsistencies.

MySpace: The Current Viewpoint of the Federal Circuit

The controversy surrounding business method patents appears to be at the heart of the Federal Circuit's inclination to avoid § 101 discussions. The Federal Circuit's recent opinion in *MySpace* illustrates this concept and debates the business method topic by addressing whether § 101 is a prerequisite in the question of patent validity. Ultimately, however, the majority circumvented this issue. Specifically, the majority used 35 U.S.C. § 102 (novelty) and 35 U.S.C. § 103 (non-obviousness) to invalidate patents rather than take the opportunity to discuss § 101 and the corresponding patentability of business methods debate.

At issue in the *MySpace* case were four database patents owned by GraphOn Corp., which was attempting to enforce its patent rights in several infringement suits. The district court in *MySpace* found all four of the GraphOn patents to be invalid as anticipated, or rendered obvious by prior art.

As noted, the majority focused on the anticipation and obviousness issues, while reviewing the claim construction to determine whether the patents in question covered hierarchical as well as relational databases. However, the dissent strongly argued that the invalidity should have been based on § 101 grounds, asserting the premise that § 101 is in fact a "threshold" test that should precede novelty and non-obviousness analyses.

The *MySpace* majority noted that the § 101 issue was not raised in the lower courts, and thus did not think it should be discussed on the appellate level in this particular case. Admitting that the courts have been less than successful in explaining the abstract idea exception to patentability when referring to business methods, the majority simply thought it best to rely on § 102, § 103, and § 112 when possible, because these criteria are "well developed and generally well understood." Referring to § 101 as a "swamp of verbiage," the majority suggested that litigants should assert grounds of novelty, non-obviousness, and written description as an initial matter.

The dissent pointed to previous case law, notably *Bilski*, that explicitly called § 101 an antecedent inquiry. In applying the abstract idea exception, the dissent found the GraphOn patents to be even broader in scope than the *Bilski* patents, thus rendering them unpatentable.

It is interesting to note that the Supreme Court itself recently mirrored the *MySpace* dissent opinion by implying that § 101 determinations should continue as precursors. In *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, the Court specifically declined to adopt one party's suggestion that § 102, § 103, and § 112 issues can be used to perform initial analyses, rather than § 101. Although the patentable subject matter exception evaluated in *Prometheus* was the law of nature exclusion — not the abstract idea principle — it is significant that the Supreme Court acknowledged the

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Guidelines for Maximizing D&O Insurance Coverage For SEC Matters

By Katherine Henry

Most corporate counsel know that their D&O insurance may advance or reimburse defense costs, and settlements or judgments incurred in civil litigation naming their directors and officers (as well as the company if entity coverage is purchased). Depending upon policy terms, D&O insurance may also pay defense costs incurred in response to various Securities and Exchange Commission (SEC) actions as well, including an informal investigation, a formal order of investigation, a subpoena or an indictment. Coverage varies widely depending upon the D&O policy terms. Any corporate counsel approached by the SEC must tread carefully, as hundreds of millions of dollars in coverage have been lost by major corporations facing SEC matters.

The following are some inquires and suggestions designed to help in-house counsel secure their rights under D&O policies in SEC matters and derive the greatest benefit from their premiums.

Does the SEC Matter Constitute a Claim or Circumstances That May Give Rise to a Claim?

Counsel should first determine whether a claim has been made that triggers coverage under the D&O policy. Claim definitions span a continuum from very narrow, *e.g.*, "written notice of a demand for monetary or non-monetary relief," to express inclusion of investigations and subpoenas (for example, a civil, criminal, or administrative or regulatory investigation of a director of officer: 1) once that director or officer is identified in writing as being a person against whom a proceeding may be commenced; or 2) in the case of an SEC investigation, after service of a subpoena).

These differing claim definitions rendered a significant difference in available coverage. Likewise, some policies define a Securities Claim to include "a formal or informal administrative or regulatory proceeding or inquiry commenced by the filing of a notice of charges, formal or *informal* investigative order or similar document." (Emphasis added.) This definition was sufficient to trigger coverage for a SEC subpoena and oral request for documents in *MBIA, Inc. v. Federal Insurance Co.*, 652 F. 3d 152 (2d Cir. 2011). The court held that a subpoena could be construed as a "formal or informal investigative order," or, at a minimum, "a similar document," and thus constituted a covered "Securities Claim."

In contrast, a definition of "Securities Claim" that excluded coverage for investigations" and proceedings" but restored "coverage for proceedings" (but not investigations) did not encompass an SEC letter inquiry. *Office Depot Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 2011 WL 4840951, (11th Cir., Oct. 13, 2011). Thus, counsel must carefully compare the D&O policy's claim definition with the particular SEC letter, demand, subpoena, etc., to determine whether the SEC has asserted a claim under the policy.

Complicating this analysis is the question against whom the claim is directed. For example, if a subpoena seeks documents related to an investigation of another company or individual (as opposed to an insured), the insurer may take the position that the claim is not "made against the insured" and therefore is not covered. The claim must be made against an insured person as a director or officer of the company or against the company if the company has purchased entity coverage. If the SEC has not yet identified a target, but is only collecting information, the insured will have a more difficult time arguing that a claim has been asserted against an insured. Therefore, counsel must examine not just the language of the SEC communication, but at whether the communication suggests a claim against an insured.

Even if the matter at hand does not satisfy the definition of claim, it may well meet the definition of circumstances that may give rise to a claim. D&O policies allow insureds to provide insurers with notice of circumstance that could give rise to a claim. For example, if the insureds "become aware of any circumstances which may reasonably be expected to give rise to a claim" and give written notice to the insurer of the circumstances, then any claim subsequently made against the insureds arising out of the same circumstances will be considered to be given at the time of the notice of circumstances. Thus, if a company gives notice of an informal investigation but its D&O policy limits a claim to a formal investigative order, any subsequent formal investigative order arising out of the same informal investigation would be treated as a claim under the policy. Corporate counsel should therefore carefully review the policy's notice of circumstances provision.

What Are the Requirements For Notice of Claim?

Notice of Claim

D&O policies are claims-made policies and require written notice during the policy period or an extended reporting period if purchased — and typically require notice as soon as practicable. These policies often specify particular requirements for a notice of claim, including, *e.g.*, identifying the policy number and specifically requesting coverage. They also may require that notice be communicated in a certain way, whether by certified mail, express courier, or e-mail, and will specify an address. Be cautious with package policies, which include different types of coverage, because the notice conditions for the D&O coverage may be found in the General Terms and Conditions section rather than in the D&O section of the policy. Package policies may also require the insured to identify the particular section of the policy under which coverage is sought.

Notice of Circumstances

D&O policies typically itemize requirements for notice of circumstances, such as the alleged wrongful acts that form the basis of the potential claim. Counsel should carefully

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D&O Coverage

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read the notice section of the policy to ensure compliance. Unlike other policies where transmittal of a civil complaint constitutes adequate notice, a simple transmittal of an SEC inquiry may not be considered sufficient.

Does the Policy Advance or Reimburse Defense Costs?

Some D&O policies pay defense costs as incurred so that the individual insured (or the indemnifying company) need not advance defense costs and seek reimbursement from the insurer. Corporate counsel should review the defense costs provisions to ensure that they are receiving the coverage that the company purchased and are not seeking reimbursement when the policy provides for payment of costs as incurred. Some policies also explicitly require insureds to repay non-covered defense costs advanced by the insurer: The latter "will pay covered defense costs on an as-incurred basis. If it is finally determined that any defense costs paid by the insurer are not covered under this policy, the insureds agree to repay such non-covered defense costs to the insurer." Counsel should be aware of such provisions in the event that a coverage dispute results in an adverse outcome for the insureds.

How Can We Maximize Coverage?

Insureds and their insurance companies often dispute the scope of defense costs that are covered by a policy once a claim is established. D&O policies include allocation clauses that are generally favorable to the insurer because they allow the insurer to use its "best efforts" to allocate defense costs among covered and uncovered claims or persons based on the "relative legal exposures." These clauses typically force the insured parties to discount defense costs in negotiations with their insurers, or resort to formal proceedings to determine any disputed amounts. For example, if counsel represented both an insured and an uninsured individual, the insurer may attempt to push defense costs toward the uninsured individual. Careful time-keeping can reduce the effectiveness of such insurer strategies.

What Are the Requirements For Keeping the Insurer Apprised of Developments?

D&O policies require insureds to cooperate with their insurers in defense of claims. For example, they may require that the insureds give them "all information, assistance and cooperation that the insurer may reasonably request." The scope of the insured's duty may depend on the insurer's defense obligation, with reimbursement policies posing a less onerous duty to cooperate than policies that pay defense costs as incurred. Provision of attorney-client privileged or work-product information to an insurer could be construed as a waiver if the insurer has not agreed to pay defense costs or defend the insured.

Therefore, insureds should insist that insurers take a formal coverage position before providing written documentation that, if disclosed to a third party (*e.g.*, plaintiffs in a class action arising from the SEC matter), could be damaging to the insureds. The tension between adequate disclosure, including satisfaction of the duty to cooperate, and protection of privileges, can be a difficult one, and may vary by state law. Individual directors and officers may have additional Fifth Amendment or privilege concerns that need to be protected.

What Is the Scope of Potentially Applicable Exclusions?

Conduct Exclusions

D&O policies typically exclude coverage for certain intentional conduct, such as fraud. The question arises when these conduct exclusions are triggered. Broader conduct exclusions refer to a finding "in fact," which allow the insurers to argue that any factual finding of the defined conduct triggers the exclusion. More favorable policies, however, require "final adjudication," preferably in an underlying action. In the context of an SEC proceeding, this language requires a judicial finding of the wrongful conduct in the underlying enforcement action. Settlement without any final adjudication avoids this exclusion.

Civil Fines and Penalties

Some policies expressly grant coverage for civil fines and penalties unless unenforceable by governing law. Other policies exclude this category of damages. Some D&O insurers have successfully characterized damages in securities enforcement actions as restitution or disgorgement of ill-gotten gains and therefore unenforceable as a matter of law or pursuant to specific exclusions for disgorgement or restitution.

Governmental or Regulatory Investigations

Some D&O policies expressly encompass regulatory exclusions that identify specific regulatory agencies; others either do not identify the agencies, or better yet, omit such regulatory exclusions. These exclusions are not as common as some other exclusions.

Obtain Insurer Consent Before Settlement

D&O policies typically require the insured to obtain the insurer's consent to settlement, which may not be unreasonably withheld. Unfortunately, insurers can use the consent requirement as a trap for the unwary insured. Insurers can withhold consent on the ground that they need more information before granting consent, and then when the insured resolves the matter, deny coverage on the ground that the insured did not obtain consent. Nevertheless, insurers that refuse to participate in settlement discussions and expressly deny consent may waive the consent requirement in the policy.

The insured should create an adequate record to establish the futility of obtaining consent from a recalcitrant insurer. If the company must settle the matter without the insurer's consent, counsel should pay special attention to policy exclusions and relevant law and avoid using language in settlement documents that could inadvertently give rise to coverage defenses.

Are There Exhaustion Issues In a Tower of Coverage?

Insureds often purchase a D&O tower of coverage, which includes a primary policy with excess policies sitting above the primary layer. In settlement negotiations involving claims that exceed the primary coverage and reach into the excess layer, insureds should be careful to

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Seventh Circuit: Reassignment of Disabled Workers Is Not Required

By Anthony Haller and Lucas Hanback

The United States Court of Appeals for the Seventh Circuit recently ruled in *EEOC v. United Airlines, Inc.*, No. 11-1774 (March 7, 2012) that the Americans with Disabilities Act (ADA) does not require employers to reassign disabled employees to vacant positions for which they are qualified if better qualified candidates apply and it is the employer's "consistent and honest" policy to hire the best qualified applicant. This decision was in keeping with prior Seventh Circuit precedent in cases like *EEOC v. Humiston-Keeling*, 227 F.3d 1024 (7th Cir. 2000). The issue has split the federal appeals courts, with the Tenth and District of Columbia (D.C.) Circuits holding that the ADA requires reassignment; the First, Third, Fifth and Federal Circuits holding that reassignment may be required if the employee shows "special circumstances"; and the Eighth Circuit simply holding that reassignment is not required.

The Seventh Circuit's Decision in *United Airlines*

The policy at issue in *United Airlines* required disabled employees to follow a competitive transfer process if they needed reassignment to accommodate their disabilities. Although this process gave disabled employees "a preference" for the position when they were equally qualified with another applicant, the competitive nature of the process allowed United Airlines to fill vacant positions with other, more qualified applicants instead of disabled employees. The EEOC filed suit to challenge this policy in May 2009 on behalf of five disabled employees. The District Court for the Northern District of Illinois granted United Airlines' motion to dismiss under the rationale that controlling Seventh Circuit precedent, as announced in *Humiston-Keeling*, does not require the reassignment of a disabled employee. On appeal, the EEOC argued that the Supreme Court's decision in *US Airways, Inc. v. Barnett*, 535 U.S. 391 (2002), undercut *Humiston-Keeling*, and that *Barnett* requires that disabled employees be reassigned to vacant positions. The Seventh Circuit disagreed and affirmed the district court's decision. However, because it found the EEOC's argument persuasive, the court recommended *en banc* review to consider whether the EEOC's position was correct.

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Barnett and the Circuit Split

In *Barnett*, the Supreme Court ruled that a request for reassignment was not automatically unreasonable simply because it would provide a preference to a disabled employee in violation of a seniority system. 535 U.S. at 398. The Supreme Court then outlined an approach for analyzing the reasonableness of requests for reassignment that violate established seniority systems. The court held that ordinarily, a request for reassignment that violates a seniority system will be unreasonable unless a plaintiff shows "special circumstances" that justify departure from the system. *Id.* at 403. If the plaintiff can show "special circumstances," the burden shifts back to the employer to show that the requested reassignment poses an undue hardship.

In the wake of *Barnett*, the circuit courts have interpreted the evidentiary burden imposed in reassignment cases involving seniority systems or other nondiscriminatory rules in different ways. Deriving their reasoning from cases like *Smith v. Midland Brake Inc.*, 180 F.3d 1154 (10th Cir. 1998), and *Aka v. Wash. Hosp. Ctr.*, 156 F.3d 1284 (D.C. Cir. 1998), the Tenth and D.C. Circuits hold that the employer has an affirmative obligation to reassign employees despite an established seniority system or other non-discriminatory rule unless the employer demonstrates undue hardship. *See, e.g., Duvall v. Georgia-Pacific Consumer Prods., L.P.*, 607 F.3d 1255, 1260-61 (10th Cir. 2010). In order to avoid reassignment, these circuits require the employer to show that the seniority system is an "important fundamental polic[y] underlying legitimate business interests." *Id.* at 1261.

Other circuits have interpreted *Barnett* to allow reassignment in violation of a seniority system only if the employee first demonstrates "special circumstances" that justify departure from the system. *See Tobin v. Liberty Mut. Ins. Co.*, 553 F.3d 121, 137 (1st Cir. 2009); *Medrano v. City of San Antonio*, 179 Fed. Appx. 897, 900-01 (5th Cir. 2006); *Office of the Architect v. Office of Compliance*, 361 F.3d 633, 641-42 (Fed. Cir. 2004); *Shapiro v. Twp. of Lakewood*, 292 F.3d 356, 360-361 (3d Cir. 2002). These courts require an employee to show either: 1) "that the employer retains the right to change the seniority system unilaterally, and exercises that right fairly frequently, reducing employee expectations that the system will be followed"; or 2) that "the system already contains exceptions such that, in the circumstances, one further exception is unlikely to matter." *Barnett*, 535 U.S. at 405. If the employee can demonstrate such "special circumstances," the request may be deemed reasonable, and the burden will shift to the employer to show undue hardship.

Finally, the Eighth Circuit has held that reassignment of a disabled employee is not required if it violates an employer's legitimate, nondiscriminatory policy to hire the most qualified candidate. *Huber v. Wal-Mart Stores, Inc.*, 486 F.3d 480, 483-84 (8th Cir. 2007). The defendants in *United Airlines* cited the *Huber* case in support of their argument that reassignment was not required under *Humiston-Keeling*.

Two Tests

With the exception of the Eighth Circuit approach, which simply holds reassignment requests to be unreasonable whenever a valid nondiscriminatory rule allows the employer to place someone else into an open position, the circuit spilt essentially centers on who bears the

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Disabled Reassignment

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burden of proof — the employee, or the employer — and the two competing tests contain different evidentiary presumptions. The test followed by the Tenth and D.C. Circuits presumes that reassignment is mandatory unless the employer proves otherwise. By contrast, the test followed by the First, Third, Fifth, Seventh, and Federal Circuits presumes that reassignment in violation of an established seniority system is unreasonable unless the employee can prove otherwise.

Imposing the burden of proof on the employer as required under the Tenth and D.C. Circuits seems inconsistent with the text of the *Barnett* opinion. The Supreme Court said that normally a request for reassignment in violation of a seniority system would be an unreasonable request because "it would not be reasonable in the run of cases that the assignment in question trump the rules of a seniority system." *Barnett*, 535 U.S. at 403. The Court then imposed a requirement for a plaintiff to show "special circumstances" justifying departure from the seniority system before she could prevail on the reasonable accommodation prong of her claim and shift the burden to the employer to prove undue hardship. *Barnett*, 535 U.S. at 405-06. The Circuits that side with the EEOC's view in *United Airlines* do not follow this analytical approach because they do not require the plaintiff to show "special circumstances" that justify departure from the seniority system or another nondiscriminatory rule.

This is a very important distinction because the two tests produce different results. Under the approach followed by the Tenth and D.C. Circuits, an employer must show that the policy is an "important fundamental polic[y] underlying legitimate business interests." *Duvall*, 607 F.3d at 1261. The application of this test may produce different results for an employer depending on how the seniority system is structured. For example, a seniority system negotiated as part of a collective bargaining agreement in order to protect worker's rights would probably pass the Tenth and D.C. Circuit test. However, another seniority system that was established by an employer to protect the seniority of the owner's friends and relatives who have worked for the company for the longest time period may fail the test because the policy would not underlie a legitimate business interest.

By contrast, the *Barnett* test grants the employer a presumption that an established seniority system always renders a request for reassignment in violation of the policy unreasonable unless the employee can first show "special circumstances" that justify departure from the policy. *See Barnett*, 535 U.S. at 408 (Stevens, J., concurring). Under the *Barnett* test, the second seniority system discussed above would pass muster, and the employee would have no claim unless she could show that special circumstances permit a departure from the established policy.

Implications

In *United Airlines*, the Seventh Circuit recommended *en banc* review to determine the validity of the EEOC's position. However, even if the full panel of the Seventh Circuit reverses the decision and adopts the EEOC's rationale, the circuit split will remain. Additionally, reversal will not change the fact that the Eighth, Tenth and D.C. Circuits appear to incorrectly interpret the Supreme Court's guidance in *Barnett*. The Eighth Circuit does not use the correct test, and the rationale used in the Tenth and D.C. circuits derives from *Midland Brake* and *Aka*, both of which were decided before *Barnett*, and their subsequent validity is questionable in light of *Barnett's* holding. The EEOC already tried to persuade the Seventh Circuit to adopt the *Midland Brake / Aka* rationale in *Humiston-Keeling*. If the Seventh Circuit refused to adopt that rationale prior to the decision in *Barnett*, it seems unlikely that it will do so now. However, should the EEOC prevail on its position *en banc*, it will deepen the existing split and likely hasten Supreme Court intervention to address this issue.

In the meantime, this recent decision from the Seventh Circuit should serve as a reminder for employers to carefully consider the propriety of reasonable accommodations for disabled workers in light of the specific facts at hand. Additionally, in cases where reassignment is requested as an accommodation and where a seniority system or similar nondiscriminatory rule is at issue, employers should carefully read *Barnett* and ensure that the analytical approach outlined in that case is correctly followed.

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Compliance

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People can argue whether the new regulations that emerged in the wake of Sarbox make sense. Either way, compliance has now become a major cost of doing business, and more importantly, one that continues to grow.

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Sarbox Was Only the Beginning

Since Sarbox took hold, it's fair to say that most businesses have managed to keep their heads largely above water when it comes to meeting compliance requirements. But while they may have weathered the storm so far, they may be less than adequately prepared for a tidal wave of additional regulations looming on the horizon.

Compliance officers can create effective compliance strategies and policies only after regulations are written and implemented. And it's the part of the iceberg you don't see that represents the forthcoming challenges. To cite just one major example, even as we approach the second anniversary of the passage of Dodd-Frank, less than a third of the legislation has been codified into regulations.

In addition, many of the new regulations are growing in complexity. Measures such as the UK Bribery Act

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Digital Copiers Don't Forget

Significant Data Security Risks to Companies

By L. Elise Dieterich

Protecting sensitive data from loss or theft has become a high-priority risk management objective for companies of all sizes, with the imperative perhaps strongest for public companies that are subject to the SEC's new cybersecurity disclosure guidance and those vulnerable to significant reputational damage in the event of a data security breach. Indeed, it is estimated that more than 30 million records were breached last year (source: Privacy Rights Clearinghouse, www.privacyrights.org/data-breach/new) at a cost to organizations of more than $200 per record (source: Ponemon Institute Study, www.ponemon.org/blog/post/cost-of-a-data-breach-climbs-higher).

Of course, risk mitigation requires a good understanding of where the vulnerabilities are, and one that many companies have missed is the sensitive data that likely resides in the hard drive memories of printers, copiers, and fax machines. Often, companies that routinely wipe the hard drives of their computers before recycling neglect to do the same for other types of peripheral machines, and may not realize that some networked digital copiers can be remotely accessed.

This issue gained prominent attention thanks to a CBS News investigative report (*see* www.cbsnews.com/video/watch/?id=6412572n). In that report, CBS revealed that one of the used copiers it obtained had in its hard drive copies of medical records belonging to Affinity Health Plan. As a result of the story, Affinity, pursuant to applicable state and federal privacy laws, was required to make breach notifications to government regulators and affected clients, patients and employees. Affinity notified some 400,000 individuals that their personal or medical data may have been compromised, and became the subject of an inquiry by HIPAA privacy authorities at the federal Department of Health and Human Services.

The Federal Depository Insurance Corporation has issued guidance for financial institutions on "Mitigating Risk Posed by Information Stored on Photocopiers, Fax Machines and Printers" (www.fdic.gov/news/news/financial/2010/fil10056.pdf). And the Federal Trade Commission (FTC) has released more general guidance entitled "Copier Data Security: A Guide for Businesses" (http://business.ftc.gov/sites/default/files/pdf/bus43-copier-data-security.pdf) advising companies on how best to protect sensitive information throughout the lifecycle of a copier or similar machine. As the FTC explains:

> Commercial copiers have come a long way. Today's generation of networked multifunction devices — known as "digital copiers" — are "smart" machines that are used to copy, print, scan, fax and e-mail documents. Digital copiers require hard disk drives to manage incoming jobs and workloads, and to increase the speed of production. … The hard drive in a digital copier stores data about the documents it copies, prints, scans, faxes or e-mails. If you don't take steps to protect that data, it can be stolen from the hard drive, either by remote access or by extracting the data once the drive has been removed.

Legislative Control

The CBS story also prompted bills to be introduced in numerous state legislatures in an effort to address this problem. ELFA, the Equipment Leasing and Finance Association, was tracking 14 bills on this issue in 2011, and predicts at least seven will be renewed for consideration this year. The majority of these bills seeks to assign responsibility for erasing or destroying the information stored on leased digital copy machines. For example, legislation pre-filed for the New Jersey legislature's 2012 session would require businesses to "destroy, or arrange for the destruction of, all records stored on a digital copy machine, which is no longer to be retained by that business, by erasing or otherwise modifying those records to make the records unreadable, undecipherable, or nonreconstructable through generally available means." Businesses that fail to comply would be subject to penalties of up to $20,000 and civil suits for compensatory and punitive damages, attorneys' fees and costs.

Addressing the Risk

With this level of attention focused on the problem, companies can ill-afford to ignore the data breach risk posed by copiers and other digital machines. In addition, it serves as a reminder to companies to be aware of the risks associated with other devices that can easily carry copies of sensitive information — such as flash drives, external hard drives and mobile devices.

Addressing the risk associated with sensitive information potentially stored on copiers and other digital machines starts with the same "data hygiene" measures recommended for paper documents and those stored on computers. First among these is knowing what kind of data is being handled, that could be exposed. Types of data vulnerable to copier-related loss or theft include:

- personal information pertaining to employees, customers or patients, including (but certainly not limited to) Social Security and other account numbers, dates of birth, financial and medical records, and contact information;
- competitively sensitive information;
- companies' intellectual property; and
- privileged legal documents.

Even where such information is closely guarded from leaving the office in other forms, it may routinely be copied for internal file-keeping or distribution. Be aware that, when the digital machine that scanned the information leaves the office, the scanned documents may well be leaving the office too.

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Digital Copier Risks

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The second important "data hygiene" measure is to understand the legal obligations associated with the vulnerable data. While loss of certain data may be embarrassing to the company or jeopardize valuable intellectual property, the loss of employees' or customers' personal information can expose a company to specific legal liability, as well as breach reporting obligations. Legal counsel with privacy expertise can assess the types of data the company is handling, help spot the risks, and identify the state and federal laws that may apply.

Third, every organization should know its partners. Frequently, digital copiers and similar office equipment are leased from third-party equipment suppliers. Leasing companies that are ELFA members should be aware of the vulnerabilities discussed in this article. Nonetheless, it is the company that owns the information that is obliged to conduct due diligence on the vendors and machines it uses. For example, HIPAA covered entities that contract with business associates to handle medical information are responsible for ensuring that their agreements with those business associates mandate compliance with the HIPAA privacy and data security rules.

Moreover, vendors can be valuable partners in securing vulnerable information. Most digital machines offer encryption or overwriting features, and many vendors will work with companies to remove or overwrite hard drives at the end of the lease term. The FTC recommends that digital copiers be included in an organization's information security policies, and managed and maintained on a routine basis by the organization's in-house IT staff, who should be sensitized to data security concerns.

Last, it is important for every organization to have a data security plan in place that addresses not only the steps necessary to identify sensitive data and keep it secure, but also the steps that will be taken if the worst occurs, and data is exposed. What proactive data protection and reactive breach notification laws apply to the kinds of data handled by the company? Who in the organization is responsible for protecting data and for detecting and responding to a breach? Is there a budget for breach response (remember that the average cost of breach response is more than $200 per compromised record)? Does the organization have appropriate insurance and indemnities in place?

Conclusion

Together, the measures discussed above can help organizations to manage the risks associated with operating in the digital environment. This is important because, in 2012, ignorance of what your copier remembers is no longer a defense.

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Compliance

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or the U.S. Foreign Account Tax Compliance Act are expanding the extraterritorial reach of regulators. Compliance officers need to ensure that operations meet not only the regulatory standards within the domestic market but also those of regulators in other jurisdictions that may apply.

Better Strategy, Not More Manpower

The oncoming flood of regulations requires fresh thinking and new approaches. Managing the growing body of regulations will obviously require expanded resources. However, there are practical limits to how successfully one can manage more regulations simply by throwing more bodies at them. As the compliance environment becomes larger and more complex, new strategic overlays need to be applied. The three primary rules of compliance are still in play: Identify, Prioritize and Mitigate. But the balance in managing those three objectives is shifting.

Until recently, the emphasis has often been on mitigation. This is certainly understandable. One of the primary objectives of the compliance role is obviously to avoid sanctions and penalties being applied against the organization. In compliance, results clearly matter. But while outcomes are definitely critical, the sheer volume of regulations facing today's businesses means that work at the front end now takes precedence.

We recently completed the "Cost of Compliance 2012 Survey," which found that more than a third of compliance professionals spend an entire working day each week staying up-to-date with regulatory changes. With the introduction of new regulations accelerating, that level of workflow is clearly unsustainable.

So effective identification and prioritization have become essential. Compliance officers must ask themselves, "How do I tackle this enormous mass of regulations and sift through it?" Reading every word of every pertinent new regulation today is an impossibility.

So the ability to prioritize and focus on which regulations, regulators and markets are most critical to the business is key to keeping up with the regulatory deluge.

Solution = Automation + Good, Old-Fashioned Brainpower

Another factor that has changed dramatically over the past 10 years is the pace of technology. But that presents a double-edged sword. The growth of computing power, particularly mobile technologies and networks operating in "the cloud," has contributed significantly to the explosive growth of data. Managing those mountains of ones and zeros only further complicates the task of ensuring that a business's information is in compliance.

Thankfully, technology also offers a measure of salvation to balance the burdens that it creates. New solutions are making it easier to sort, analyze and taxonomize those enormous piles of information. Because the information is created in an electronic environment, solutions must be able to deal with that information at the same level.

Automated tools can place pieces of information into their proper workflows, ensuring that information related to anti-money-laundering, for example, goes in one direction, while securities filings go in another direction. Automation can accomplish much of the "heavy lifting" of data piles, in somewhat the same manner as early case assessment tools can winnow reams of electronically

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ERISA Class Certification in The Wake of *Dukes* And *Amara*

By Darren E. Nadel
and Allison R. Cohn

The U.S. Supreme Court issued two starkly different decisions in 2011 that together will shape (and, indeed, have already shaped) the analysis that courts must employ in determining whether to certify ERISA class actions: *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), and *CIGNA Corp. v. Amara*, 131 S. Ct. 1866 (2011). *Dukes* has, of course, clarified the standard for determining commonality in class actions and narrowed the circumstances in which plaintiffs may certify Federal Rule of Civil Procedure 23(b)(2) class actions. *Amara* ruled that a plaintiff must establish "actual harm" from alleged misrepresentations made about upcoming changes to pension plan benefits in order to obtain "appropriate equitable relief" under section 502(a)(3) of ERISA. Taken together, *Dukes* and *Amara* make class certification exceedingly difficult (though not impossible) in the ERISA context.

Background

Prior to *Dukes*, breach of fiduciary duty claims were commonly certified under Rule 23(b)(2), which permits certification of class actions where "injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole." Certification under Rule 23(b)(2) has traditionally been easier to obtain than under Rule 23(b)(3), which permits certification of claims for monetary relief where common issues predominate over individualized issues. In February 2012, however, the Second Circuit Court of Appeals became the first circuit court post-*Dukes* to address whether a Rule 23(b)(2) class action is the proper vehicle when the plaintiffs seek monetary recovery in addition to declaratory and injunctive relief. The Second Circuit said it was not.

The Second Circuit Ruling

In *Nationwide Life Insurance Co. v. Haddock*, No. 10-4237, 2012 U.S. App. LEXIS 2340 (2d Cir. Feb. 6, 2012), the Second Circuit reversed a district court order granting class certification. The plaintiffs in *Haddock* asserted that the insurance company breached its fiduciary duty under ERISA by allegedly collecting "revenue sharing payments" from mutual funds that it selected as investment choices for its annuity holders. The district court had granted class certification under Rule 23(b)(2). In reversing, the Second Circuit went out of its way to state that the district court's order granting class certification was correct under the Second Circuit's pre-*Dukes* analysis.

However, the Second Circuit recognized that, under the Supreme Court's holding in *Dukes*, "a class complaint alleging numerous individual claims for monetary relief may not be certified under Rule 23(b)(2) 'at least where … the monetary relief is not incidental to the injunctive or declaratory relief'." *Id*. at *4 (quoting *Dukes*, 131 S. Ct. at 2557). Analyzing the suit before it, the Second Circuit concluded that the plaintiffs' claims for monetary relief were not merely incidental to the claim for equitable relief. Specifically, the Second Circuit observed that "if plaintiffs are ultimately successful in establishing [the insurance company's] liability …, the district court would then need to determine the separate monetary recoveries to which individual plaintiffs are entitled." *Id*. at *6. The Second Circuit then recognized that "[t]his process would require the type of non-incidental, individualized proceedings for monetary awards" that the Supreme Court said are impermissible under Rule 23(b)(2). *Id*. The Second Circuit has remanded the case to the district court to determine whether certification is appropriate under Rule 23(b)(3). *Id*. at *7.

In the Courts

Lower courts have also taken seriously *Dukes*' admonition that a rigorous analysis of the allegations is necessary, and they are now focusing on whether the relief sought will require the court to engage in the type of individualized inquiry that *Dukes* held was outside of the scope of Rule 23(b)(2). For example, in *Pennsylvania Chiropractic Association v. Blue Cross Blue Shield*, No. 09 C 5619, 2011 U.S. Dist. LEXIS 148689, at*42 (N.D. Ill. Dec. 28, 2011), the district court rejected an attempt to certify an ERISA class action under Rule 23(b)(2). The court relied on *Dukes*' explanation that "[t]he key to the (b)(2) class is the indivisible nature of the injunctive or declaratory remedy warranted — the notion that the conduct is such that it can be enjoined or declared unlawful only as to all of the class members or as to none of them." *Id*. at *41 (citing *Dukes*, 131 S. Ct. at 2557).

There, the plaintiffs argued that they qualified for Rule 23(b)(2) certification because they were challenging the defendants' uniform misconduct and because the recovery of damages in an ERISA action constitutes equitable relief. The Northern District of Illinois was not convinced. "The fact that monetary relief may be characterized as equitable is irrelevant." *Id*. at *41-42 (internal quotation marks and citation omitted). Rather, the monetary relief must be merely incidental — *i.e.*, a mere mechanical computation — to the grant of the injunction or declaratory relief. The plaintiff failed to make any such showing. *Id*. at *42.

Other Views

Not all lower courts, however, have paid sufficient attention to *Dukes* or *Amara*. In *Mezyk v. U.S. Bank Pension Plan*, No. 3:09-cv-384-JPG-DGW, 2011 U.S. Dist. LEXIS 146758 (S.D. Ill. Dec. 21, 2011), the plaintiffs asserted claims related to the transition from a traditional defined benefit pension plan to a cash balance plan, including claims that Plan failed to give adequate notice of an amendment that significantly reduced the rate of future benefit accruals, and that the Summary Plan Description

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Dukes *and* Amara

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(SPD) contained misleading information. The plaintiffs sought the value of the benefit to which each would have been entitled had the Plan not been amended. The district court had certified the notice and SPD claims prior to *Dukes*, and the defendant moved for decertification in light of it. The district court denied the motion, disagreeing that *Dukes* forecloses certification under Rule 23(b)(2) of claims that require individualized determinations of relief.

In a one-paragraph "analysis" of *Dukes*, the district court concluded that the relief the plaintiffs sought was for declaratory or injunctive relief that would apply to the class as a whole — a declaration that certain Plan provisions violate ERISA, an injunction requiring the Plan to cease implementing those Plan provisions and reformation of the Plan, and an injunction requiring recalculation and payment of benefits under the proper calculations. According to the district court, "[a]ny monetary relief that might flow from such a decision is incidental, which [*Dukes*] does not foreclose." *Id.* at *7-8.

Not only did the district court give *Dukes* short shrift, but it also entirely ignored *Amara's* holding that plaintiffs must establish "actual damages" prior to obtaining reformation of the plan. Under *Amara*, "to obtain relief by surcharge for violations of [ERISA] §§ 102(a) and 104(b) [for disclosure violations], a plan participant or beneficiary must show that the violation injured him or her." *Id.* at 1881. Although *Amara* held that detrimental reliance was not necessary, *i.e.*, each plaintiff need not prove that he or she actually read the misleading statements and relied on them, and instead authorized a watercooler-type theory of harm, this holding still requires courts to engage in an individualized inquiry of precisely what each class member read or heard "through fellow employees or [in] informal workplace discussion" prior to authorizing monetary relief. *Amara*, 131 S. Ct. at 1881-82. Such an inquiry should most certainly preclude Rule 23(b)(3) class actions, as the individual inquiries will predominate over any common issues, but should also preclude Rule 23(b)(2) class actions similar to *Mezyk*, where the class claim stems from the company's alleged misrepresentations. Whether the *Mezyk* holding will reach the Seventh Circuit Court of Appeals remains to be seen.

The Commonality Requirement

Another aspect of *Dukes* that has brought about changes in the lower courts' analysis is its holding regard Rule 23(a)'s commonality requirement, the rule requiring a putative class action plaintiff to show that "there are questions of law or fact common to the class." Fed. R. Civ. P. 23(a). Prior to *Dukes*, plaintiffs needed only to show a common nucleus of operative facts among the claims of the proposed class members. In practice, commonality was nearly always deemed satisfied, as "[a]ny competently crafted class complaint literally raises common 'questions.'" *Dukes*, 131 S. Ct. at 2551 (citation omitted). Post-*Dukes*, plaintiffs must now demonstrate that the common contention is of "such a nature that it is capable of classwide resolution — which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Dukes*, 131 S. Ct. at 2551.

Groussman v. Motorola, Inc., No. 10 C 911, 2011 U.S. Dist. LEXIS 134769 (N.D. Ill. Nov. 15, 2011), demonstrates the powerful effect of *Dukes* on the commonality requirement. There, the plaintiffs alleged that the defendant-company continued offering its stock as part of employees' 401(k) investments, when the company possessed negative information about its business, and failed to provide complete and accurate information to plan participants. *Id.* at *3-4. The *Groussman* plaintiffs failed the commonality test. Not surprisingly, the plaintiffs argued that the company's alleged violations arose from a common set of facts (*i.e.*, all proposed class members were participants in the plan and all had invested in the company's stock) and common legal issues (*i.e.*, whether the company violated ERISA or breached its fiduciary duties). The plaintiffs sought to ignore *Dukes*, arguing that courts in other cases of this type have found such cases to be "particularly suitable for class certification." *Id.* at *10.

The district court did not agree with the plaintiffs' argument, noting that "the determination of whether the requirements are met in this case must be made based upon a detailed and rigorous evaluation of the facts and law in this case, not based on rulings in other cases, particularly pre-*Dukes* cases." *Id.* "[F]or the commonality requirement more is required than merely some common aspects among class members." *Id.* at *9-10. The plaintiffs failed to do so, instead alleging common facts and legal issues that were precisely "the type of loose factual connections among class members that does not suffice under *Dukes*." *Id.* at *10.

By contrast, in *Merrimon v. Unum Life Insurance Company of America*, No. 1:10-CV-447-NT, 2012 U.S. Dist. LEXIS 15516 (D. Me. Feb. 3, 2012), the court determined that plaintiffs' breach of fiduciary duty claims could be determined on a classwide basis. There, the plaintiffs alleged that the insurance company breached its fiduciary duty by retaining and investing the plaintiffs' death benefits in retained asset accounts (RAAs) in a manner aimed at optimizing the company's own earnings, rather than the beneficiaries' earnings. The district court certified the class under Rule 23(b)(3), holding that the breach of fiduciary duty arose out of the company's discretionary choices to retain the assets behind the RAAs in its own general accounts and to set the features for these RAAs, including the applicable interest rates, in its own interest rather than solely in the interest of the beneficiaries. *Id.* at *39-40. "These choices affected all of the beneficiaries in a similar manner — *i.e.*, in the loss of additional interest to their accounts for the period of time in which they left their funds in the RAAs." *Id.* at *40. While the plaintiffs' individual damages would be different based on how long they kept their money in the RAAs, the court found that plaintiffs' varying motivations for leaving money in these accounts was not relevant to the company's liability or

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the calculation of damages. *Id.*; *see also Churchill v. Cigna Corporation*, No. 10-06911, 2011 U.S. Dist. LEXIS 90716 (E.D. Pa. Aug. 12, 2011) (granting Rule 23(b)(2) class certification where the plaintiffs challenged the company's national policy of denying a certain type of treatment for autism; the commonality element was satisfied "[b]ecause the entire class was allegedly harmed by [the company's] uniform policy.").

Conclusion

As the above cases make clear, obtaining class certification in the post-*Dukes* era is far more difficult, as district courts now must genuinely probe behind the pleadings and determine whether common issues will indeed answer critical questions and whether damages can be determined on a classwide basis. *Amara* adds an extra level of individualized inquiry. With the requirement of actual harm, plaintiffs must somehow show that all class members heard the same misrepresentation and reacted in the same manner. While ERISA fiduciary duty class actions will continue to be brought, the rate of success is expected to drastically decrease.

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Patentable Matter

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idea that the patentable subject matter question should remain a prerequisite to other inquiries.

Practical Takeaways for In-House Counsel

It should be clear to all that the controversy over what is acceptable subject matter for a patent is not going to subside anytime soon. However, there are definite and concrete practices that patent owners can implement now to help adapt for future changes in the law. These include:

Understand the Content of Your Patent Portfolio

Most owners of a larger number of patents have some type of administrative monitoring system in place to track their patents. Such systems typically tell the owner which patents are issued, when the patents expire, when maintenance fees are due, and the relationship among the patents (continuation, continuation-in-part, etc.). This type of information is important, but it is inadequate to truly understand what is owned. Even knowing the title and perhaps abstract of the patent is not very helpful.

Instead, it is critical to have a grasp of what the actual claims of a patent cover. This information should include: an understanding of the important limitations of the claim language; the type of claims (method, apparatus, Markush, "means/step plus function," etc.); and any prosecution file history issues affecting the patent. Once the information is collected, it is most convenient to maintain it in a database that includes the text of the claims along with notes and comments about their status.

This information is not easy to gather, evaluate and monitor, especially for a large portfolio. However, a patent owner can easily indentify which patents are affected by changes in the law if this information is readily available and understood. Then, an owner may be able to take remedial action to "repair" the patent when an issue arises, but the first step is to understand which patents are affected.

Seed the Specification with as Many Embodiments as Possible

When an application is drafted, it is important to include descriptions of as many different examples and variations of the invention as possible within the specification. These examples do not have to be embodiments that are intended to be used or sold in a product. Instead, they can be speculative and not necessarily fully developed at the time of drafting.

An application that is properly seeded gives the applicant the maximum amount of flexibility to respond to changes in the law during prosecution. With the proper supporting language, the claims of an application may be amended to comply with new standards of patentable subject matter.

For example, it is rare that a business method is not implemented in some manner by a computer. It should be standard practice that an application for such a business method will include a detailed description of how the method operates within a computer system. With adequate support in the specification, the business method claims can be amended to recite a computer software implemented method that would hopefully overcome any changes to the law affecting business method claims.

Keep the Specification of an Issued Patent Alive

Once an application receives a Notice of Allowance and is about to issue as a patent, an applicant should always file a continuation or continuation-in-part (CIP) application that claims priority from the issued patent in order to keep the specification alive. A continuation application is a new application that contains the entire specification of the parent, but contains new claims. In comparison, a CIP may include new disclosure material that covers improvements and refinements of the invention. If the law changes to adversely affect the claims of the issued patent, the continuation or CIP application can be amended to include "repaired" claims from the issued patent that overcome the changes in the law.

It is an important practice procedure that any CIP filing must include the complete and total text of the parent specification in its application. Any new matter in the CIP should be added to the parent specification and not used to replace it. Otherwise, key parts of the parent disclosure that are needed to remediate the parent's claims may have been deleted.

Also in a CIP filing, a parent specification that has been seeded with speculative embodiments as mentioned previously, may now include more detail about such embodiments. An applicant can attempt to use these expanded disclosures to draft new claims to adapt to the changes in the law.

Conclusion

Clearly, the limits of patentable subject matter will continue to be

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Patentable Matter

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a contentious issue as a satisfactory resolution continues to elude the courts. Consequently, the boundaries of patentable subject matter in terms of business methods, computer software and many areas of biotechnology will remain blurred and indistinct.

As a practical matter, the courts will not be able to avoid the issue indefinitely. The USPTO, patent prosecutors, and the inventors and owners of these types of patents all need and demand guidance from the judiciary regarding the standards of patentability for business methods, computer software and the like. Corporate counsel should monitor this debate and understand the issues involved while actively adapting their patent strategy for the changes in the law.

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Compliance

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stored information for litigation into discretely coded, sorted and prioritized bundles.

But at some point, effective compliance still must rely on the human element — the application of clear, analytical thinking and problem-solving skills. Using automation to effectively parse, taxonomize and prioritize data improves efficiency by freeing compliance officers to focus on information that is truly "mission-critical" to the business.

Investment and Commitment

In an era of tightening corporate budgets and still-jittery financial markets, securing the level of corporate resources needed to meet compliance requirements adds an additional layer of challenge. Growing requirements coupled with increasing competition for experienced talent are driving up costs. In our recent survey of more than 500 compliance professionals at companies around the globe, fully 70% expect the cost of senior compliance staff to be higher this year. At the same time, only 11% of companies expect a significant increase in their budgets for compliance this year, even as major portions of Dodd-Frank and other reforms take hold in the coming months.

Beyond the financial commitment, the compliance function also needs the proper authority and support from the board and upper management or it will not succeed. I recently participated in a panel discussion with several compliance officers who agreed that given its growing level of responsibility, the position should either report directly to, or at least have direct access to, the board and CEO. In addition, the position must have the authority to report in an executive session to either the board or the audit committee, allowing the chief ethics and compliance officer to address issues without management interference.

Chief compliance officers must be free to perform their duties in supporting the interests of the company within their organizations. Support from above and authority to act are vital in this regard. An effective chief ethics and compliance officer raises tough questions, interviews employees at all levels as well as partners and suppliers, reviews documents and more, and must be able to do so without impediment from others inside or outside of the organization.

Sarbox +10: Now What?

Sarbanes-Oxley was the dawn of a new era of regulation, and at the time, many of us were somewhat shell-shocked at the broad expanse of the new requirements. Businesses were being stretched to meet its requirements. Looking back, however, Sarbanes-Oxley merely set the bar for the wave of regulations that followed and is no longer the Mother of All Regulations it once was. And looking back at Sarbox only serves to remind us of the importance of looking forward in order to be properly prepared for what we know lies ahead.

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D&O Coverage

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avoid providing the excess insurers an escape hatch depending upon the language of the excess policy.

If the excess policy requires that the underlying insurer pay the full amount of the underlying limit, and the insured accepts less that the full amount from the primary insurer and fills the gap with its own funds, the excess insurer could prevail on an argument that a precondition to excess coverage has not been satisfied. Other policies contain less restrictive language, requiring, for example, only that the underlying amounts be paid (whether by the primary insurer or the insured) and thus may close this excess insurer loophole.

Conclusion

When possible, corporate counsel should communicate with their in-house risk management counterparts to negotiate terms and conditions that are favorable to coverage for SEC matters as well as other potential threats to the company and its directors and officers. Careful negotiating of terms and conditions at the outset can avoid many of these pitfalls. After all, the best time to ensure adequate insurance coverage is not when the loss occurs, but when the company negotiates coverage.

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