WEIL, GOTSHAL & MANGES LLP

VOL. 16 NO. 9 SEPTEMBER 2004

Business & Securities Litigator

An Update on Recent Developments Prepared by the
Business & Securities Litigation Department of Weil, Gotshal & Manges LLP

Reprinted From Aspen Corporation Bulletin

Court Finds No D & O Coverage – For Any Director – Due To Personal Benefit Gained By Majority Shareholder By Obtaining Funds For Corporation

By Glenn D. West and Stephen A. Radin

The United States Court of Appeals for the Fifth Circuit's recent two-to-one decision in *TIG Specialty Insurance Co. v. PinkMonkey.com Inc.*, 375 F.3d 365 (5th Cir. 2004), holds (1) that the chairman, chief executive officer and majority shareholder of a start-up internet company gained a personal profit by securing funds from investors for the company – not himself – and thereby triggered a personal profit exclusion in the company's directors and officers ("D & O") insurance policy, and (2) that the D & O policy personal profit exclusion excluded coverage not just for the insured chairman, CEO and majority shareholder found to have gained a personal profit, but also for all other insured directors and officers.

Continued on page 2

The Seventh And Ninth Circuits Revisit The PSLRA's Safe Harbor And Pleading Requirements

By Paul Dutka and Joshua S. Amsel

Two recent federal Courts of Appeals decisions – the Seventh Circuit's decision in *Asher v. Baxter International Incorporated*[1] and the Ninth Circuit's decision in *Nursing Home Pension Fund, Local 144 v. Oracle Corporation*[2] – constitute the latest jurisprudence, respectively, on the safe harbor for forward-looking statements and the heightened pleading requirements under the Private Securities Litigation Reform Act of 1995 (the "PSLRA").

In *Baxter*, the Seventh Circuit reversed the district court's dismissal of the complaint, holding that the undeveloped record did not reveal a basis upon which to conclude either that the defendant corporation's cautionary statements identified the important variables potentially affecting the corporation's performance, or that the corporation had amended its cautionary statements as the risks facing the corporation changed.[3]

Continued on page 4

IN THIS ISSUE

Court Finds No D & O Coverage – For Any Director – Due To Personal Benefit Gained By Majority Shareholder By Obtaining Funds For Corporation 1

The Seventh And Ninth Circuits Revisit The PSLRA's Safe Harbor And Pleading Requirements 1

No D & O Coverage

Continued from page 1

The decision, construing Texas law and written by Circuit Judge Emilio M. Garza and joined by Circuit Judge Rhesa H. Barksdale – together with a strongly worded dissent written by Circuit Judge Charles Willis Pickering, Sr. – illustrates:

- the possibility that courts may deem substantial shareholders of a corporation who obtain investments for the corporation to have gained a personal profit from these investments;
- the careful parsing of words that often characterizes D & O coverage litigation;
- the fact that D & O insurers often try to deny coverage – and sometimes succeed – where insured directors or officers are found to have engaged in improper conduct; and
- that directors and officers who have done nothing wrong – and whose own conduct triggers no policy exclusion – may find themselves without insurance due to the actions of an insured other than themselves.

The decision involved a start-up business and a Texas statute that arguably provides grounds for limiting the decision's reach, particularly in the context of the breach of fiduciary duty and federal securities law claims often brought against directors or officers.

Nevertheless, two practice points should be emphasized.

First, directors and officers of start-up and private equity funded businesses and their counselors, however, would be well advised to review their D & O policies and consider taking steps to ensure that securing investments for a corporate or other business entity does not give rise to a personal benefit triggering a personal profit exclusion. An endorsement such as the following would accomplish this goal:

> Nothing in the Personal Profit Exclusion in § __ of this Policy excludes coverage for any claim against any Insured for personal profit, remuneration or advantage the Insured derives as the result of an investment of funds in [the Company] if no profit, remuneration or advantage is gained by the Insured as a result of the investment other than as a shareholder or owner of the entity.

Second, and particularly important from the perspective of outside directors – D & O policies should be reviewed to

WEIL, GOTSHAL & MANGES LLP'S BUSINESS & SECURITIES LITIGATION DEPARTMENT

Formed in 1984, Weil, Gotshal & Manges LLP's Business & Securities Litigation Department now is a 51-lawyer litigating and counseling group, which also works extensively in conjunction with the firm's other departments and practice groups. The Department's litigation practice involves a wide range of corporate, securities, accounting, creditor rights and other complex business cases in numerous jurisdictions, and has included a substantial number of the leading mergers and acquisitions, class action, derivative action and corporate law cases decided during the last decade. The Department's counseling practice includes representation of boards of directors, senior management and independent board committees with respect to numerous corporate governance, business judgment, disclosure, investigatory, regulatory and other issues. The Department's counseling practice also includes representation of a wide range of diverse clients on a broad spectrum of transactional matters, including negotiated acquisitions, contests for control, proxy contests, going private transactions and corporate restructurings. The Department also represents clients in Securities and Exchange Commission proceedings.

Partners
Irwin H. Warren
Greg A. Danilow
Joseph S. Allerhand
Richard L. Levine
Stephen A. Radin
Miranda S. Schiller
Richard W. Slack
Paul Dutka
Robert F. Carangelo, Jr.
Diane Harvey
Anthony J. Albanese
John A. Neuwirth

Of Counsel
Seth Goodchild
Paul A. Ferrillo

Associates
Ashley R. Altschuler
Jonathan D. Margolis
Erin J. Law
Daniel Sangeap
Joshua S. Amsel
Catherine Ciarletta
Nader Mobargha
Kenneth M. Murray
Bradley R. Aronstam
Ashish D. Gandhi
Deborah Maher
Alison S. Aaronson
Monte Albers de Leon
Cara Hirsch
Virginia H. Johnson
Lavell Malloy
Stacy Nettleton
Adam M. Schloss
Robert G. Sweeney
Jaclyn Brownstein
Sarah M. Green
Richard Jacobsen
Brian Kidd
Michele C. Lamberti
Etan Mark
Kathleen Murphy
Ryan M. Philp
Margarita Platkov
Joanna R. Varon
Charles Walsh
Rachel Brochstein
Caitlyn Campbell
Melissa Carvalho
Stefania DiTrolio
David Holahan
Robert Polemini
Lauren Thelander

Editor: Paul Dutka

Special thanks to Glenn D. West, Stephen A. Radin, Joshua S. Amsel, William Gordon and Ed Hart for their contributions to this issue.

The *Business & Securities Litigator* is published monthly by the Business & Securities Litigation Department of Weil, Gotshal & Manges LLP • 767 Fifth Avenue • New York, NY 10153 • (212) 310-8000 •

©2004 All Rights Reserved. Quotation with attribution is permitted. This newsletter provides general information and should not be used or taken as legal advice for specific situations, which depends on the evaluation of precise factual circumstances.

Articles from past issues of Business & Securities Litigator are available online at

www.weil.com

ensure coverage for innocent directors and officers for conduct that may trigger a personal profit exclusion with respect to any other director or officer. Many policies already include language addressing this issue by specifically providing that "the facts pertaining to and knowledge possessed by any Insured shall not be imputed to any other Insured" for the purpose of the personal profit and other similar exclusions. Where such language is not present in a policy, an endorsement as simple as the following would be sufficient:

> Nothing in the Personal Profit Exclusion in § __ of this Policy excludes coverage for any claim against any Insured who did not himself or herself gain any personal profit, remuneration or advantage to which that Insured was not legally entitled.

* * *

"[D]irectors and officers of . . . private equity funded businesses . . . would be well advised to review their D & O policies . . . to ensure that securing investments for a corporate or other business entity does not give rise to a personal benefit triggering a personal profit exclusion."

The *PinkMonkey.com* case involved a jury verdict against Patrick Greene, the chairman, chief executive officer and majority shareholder of PinkMonkey.com, a start-up internet company having four employees and operating out of a garage, for statutory stock fraud under Section 27.01 of the Texas Business and Commerce Code in connection with a capital investment by five individuals in PinkMonkey.com. "In order to find Greene liable for statutory stock fraud" under this particular Texas statute, "the jury was required to find that he 'benefited from the false representation or promise,'" and a personal profit exclusion in PinkMonkey.com's D & O policy, issued by TIG Specialty Insurance, read, in full, as follows:

> III. EXCLUSIONS
>
> This insurance does not apply to any Claim made against any Insured arising out of any of the following: . . .
>
> L. Any Claim based upon, arising from, or in consequence of an Insured having gained in fact any personal profit, remuneration, or advantage to which such Insured was not legally entitled.

Greene

In a ruling joined by all three judges on the Fifth Circuit panel that decided the case, the court held that the personal profit exclusion barred coverage for Greene.

The court stated that the term "benefit" in the statute was "synonymous" with the terms "profit" and "advantage" in the policy exclusion and that a majority shareholder in a small start-up company "gains a personal advantage from a sizeable capital investment in the company because it gives the majority shareholder the opportunity to become the owner of a successful business." In support of his proposition, the court cited *Jarvis Christian College v. Nat'l Union Fire Ins. Co.*, 197 F.3d 742, 747 (5th Cir. 1999), a case holding that an investment in a new business accrues to the personal advantage of the owner of a 49% interest in the business "by infusing his business with substantial investment capital by which to operate his business."

As a result, the court found, "Greene's statutory stock fraud conviction indicates that he gained in fact a personal profit or advantage." Greene was not legally entitled to this "personal profit or advantage," the court also found, because "[a] defendant is not legally entitled to an advantage or profit resulting from his violation of law if he could be required to return such profit" and "[t]he remedies for a violation of § 27.01 include the equitable remedy of rescission, which requires the return of any money paid."

The court accordingly held that "[b]ecause return of the capital investment in PinkMonkey could have been required, there was no legal entitlement to the capital investment," that "Greene's fraud resulted in the capital investment, which led directly to his personal advantage," and that "Greene was not legally entitled to profit from his fraud." Coverage for Greene therefore was excluded by the personal profit exclusion.

Other Directors and Officers

The court divided with respect to PinkMonkey.com's other directors and officers, who did not themselves obtain an improper profit or gain, but who had settled claims or been found liable for violations other than § 27.01 "based upon Greene having gained an advantage to which he was not legally entitled."

The majority held that the "plain language" of the personal profit exclusion barred coverage for all directors and officers, not just Greene. The court reasoned as follows:

> The exclusion does not require that the claim be based upon *the Insured*, *that Insured* or *such Insured* having gained a personal profit or gain, but based upon *an Insured* having gained a personal profit. Although the terms "the Insured," "that Insured" or "such Insured" preceding personal profit would indicate the same insured as the claim is brought against, the Personal Profit Exclusion uses the more general term "an Insured." This indicates that coverage is excluded for all Insureds, not merely the Insured who profited.

The court added that "[b]y considering the entire provision, it is clear that a claim arising out of an Insured having gained personal profit is not limited to a claim against the Insured who profited." The court explained that the exclusion uses "the specific term 'such Insured' to indicate the same insured as previously

Continued on page 7

PSLRA's Safe Harbor And Pleading Requirements

Continued from page 1

In *Oracle*, the Ninth Circuit considered the PSLRA's requirement that a complaint "'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,' or scienter,"[4] and held that although plaintiffs' allegations, when considered individually, may not have created that strong inference, "the totality of the allegations" created the necessary strong inference and required reversing the district court's order dismissing the complaint.[5]

Baxter And The PSLRA's Safe Harbor For Forward-Looking Statements

In *Baxter*, litigation ensued after Baxter International Incorporated's ("Baxter") financial results for the second quarter of 2002 fell below analysts' expectations and the corporation's shares tumbled from $43 to $32.[6] Plaintiffs, a purported class of Baxter shareholders, argued that the $43 share price resulted from materially misleading projections issued after the third quarter of 2001, projections that Baxter purportedly reiterated "until the bad news came out on July 18, 2002."[7] Plaintiffs specifically alleged that Baxter's projections did not identify six variables that could affect its results.[8]

The district court examined the forward-looking statements, including Baxter's projection "that during 2002 the business would yield revenue growth in the 'low teens' compared with the prior year, earnings-per-share growth in the 'mid teens,' and 'operational cash flow of at least $500 million,'" and determined that these forecasts fell within the PSLRA's safe harbor for forward-looking statements (*i.e.*, Section 77z-2 of the Securities Act of 1933 and Section 78u-5 of the Securities Exchange Act of 1934), thus requiring dismissal of the complaint.[9] The district court held that Baxter's forward-looking statements were accompanied by cautionary language sufficient to satisfy the safe harbor – "'meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement'"[10] – because the cautionary language dealt directly with Baxter's business, identifying potential risks and specific product lines potentially affected.[11]

On appeal, plaintiffs raised two main arguments to undermine Baxter's reliance on the safe harbor: that Baxter's cautionary statements both (i) failed to identify any of the factors alleged in the complaint as affecting the company's operations and financial results and (ii) "did not follow the firm's fortunes" because they remained unchanged as specific segments of Baxter's business suffered.[12]

Before considering these arguments, the Seventh Circuit first addressed the threshold issue whether Baxter placing cautionary statements in its SEC filings relieved the company from potential liability for statements in press releases and oral statements by Baxter executives relating to the company's projected results.[13] Plaintiffs argued that Baxter's failure to (i) include meaningful cautionary language in its press releases and (ii) have its executives, when offering oral projections, refer analysts to the cautionary language in its SEC filings, required the case to proceed even if the language in Baxter's SEC filings satisfied the safe harbor.[14] In response, the Seventh Circuit held that plaintiffs' argument would be correct in a "traditional" securities suit, in which "an investor claimed to have read or heard the statement and, not having access to the truth, relied to his detriment on the falsehood,"[15] but that plaintiffs' fraud-on-the-market claim assumed all public information had affected the share price:

> When markets are informationally efficient, it is impossible to segment information as plaintiffs propose. . . . An investor who invokes the fraud-on-the-market theory must acknowledge that *all* public information is reflected in the price, just as the Supreme Court said in *Basic*. Thus if the truth or the nature of a business risk is widely known, an incorrect statement can have no deleterious effect, and if a cautionary statement has been widely disseminated, that news too affects the price just as if that statement had been handed to each investor. If the executives' oral statements came to plaintiffs through professional traders (or analysts) and hence the price, then the cautions reached plaintiffs via the same route. . . . So we take the claim as the pleadings frame it: the market for Baxter's stock is efficient, which means that Baxter's cautionary language must be treated as if attached to every one of its oral and written statements.[16]

Having imputed the cautionary language in Baxter's SEC filings to all of Baxter's statements (written and oral) at issue, the Court moved to plaintiffs' main arguments: that Baxter's cautionary language failed to identify the six factors mentioned in the complaint as allegedly affecting the company's operations and financial results and that Baxter's cautionary language had failed to follow the company's fortunes.

The Court first observed that although "[t]he statutory safe harbor forecloses liability if a forward-looking statement 'is accompanied by meaningful cautionary statements . . .[,]' [t]he fundamental problem is that the statutory requirement of 'meaningful cautionary statements' is not itself meaningful":

> What must the firm say? Unless it is possible to give a concrete and reliable answer, the harbor is not "safe"; yet a word such as "meaningful" resists a concrete rendition and thus makes administration of the safe harbor difficult if not impossible. It rules out a caution such as: "This is a forward-looking statement: caveat emptor." But it does not rule *in* any particular caution, which always may be challenged as not sufficiently "meaningful" or not pinning down the "important factors that could cause actual results to differ materially" – for if it *had* identified all of those factors, it would not be possible to describe the forward-looking statement itself as materially misleading. A safe harbor matters only when the firm's disclosures (including the accompa-

nying cautionary statements) are false or misleadingly incomplete; yet whenever that condition is satisfied, one can complain that the cautionary statement must have been inadequate. The safe harbor loses its function. Yet it would be unsound to read the statute so that the safe harbor never works; then one might as well treat § 77z-2 and § 78u-5 as defunct.[17]

Faced with this lack of guidance, the Court analyzed Baxter's cautionary statements. In so doing, the Court acknowledged the parties' agreement with respect to two propositions: First, "boilerplate" warnings are insufficient; rather, "cautions must be tailored to the risks that accompany the particular projections."[18] Second, the cautions do not have to foretell those variables that ultimately caused the projections to be inaccurate – "prevision is not required."[19] But the Court noted that these propositions "don't decide any concrete case" and resulted merely from political compromise "between legislators who did not want any safe harbor . . . and those who wanted a safe harbor along the lines of the old Rule 175 . . . that did not require any cautionary statements but just required the projection to have a reasonable basis."[20] Given this, the statutory language "does not encode a principle on which political forces agreed as much as it signifies conflict about both the scope and the wisdom of the safe harbor. Compromises of this kind lack spirit. Still, the language was enacted, and we must make something of it."[21]

The Court emphasized that adequate cautions must fall between caveat emptor-like statements such as "'all businesses are risky' or 'the future lies ahead'" and a mere recitation of the issuer's lines of business, accompanied by a statement to the effect of "'we could have problems in any of these.'"[22] "What investors would like to have is a full disclosure of the assumptions and calculations *behind* the projections; then they could apply their own discount factors."[23] But the Court recognized that this information would help the company's competitors more than its investors.[24] An alternative suggested by the Court would be to disclose probabilities for the various projections. But this too presents problems for the company if the available information is not conducive to being stated in probabilities.[25]

"[*Baxter* and *Oracle*] constitute the latest jurisprudence, respectively, on the safe harbor for forward looking statements and the heightened pleading requirements under the PSLRA."

In the end, the Court held that perfect disclosure need not be the enemy of good disclosure because "the PSLRA does not require the *most* helpful caution. . . . [I]t is enough to point to the principal contingencies that could cause actual results to depart from the projection."[26] The Court continued:

> The statute calls for issuers to reveal the "important factors" but not to attach probabilities to each potential bad outcome, or to reveal in detail what could go wrong; as we have said, that level of detail might hurt investors (by helping rivals) even as it improved the accuracy of stock prices. (Requiring cautions to contain elaborate detail also would defeat the goal of facilitating projections, by turning each into a form of registration statement. Undue complexity would lead issuers to shut up, and stock prices could become even less accurate. Incomplete information is usually better than none, because market professionals know other tidbits that put the news in context.) Moreover, "[i]f enterprises cannot make predictions about themselves, then securities analysts, newspaper columnists, and charlatans have protected turf. There will be predictions aplenty outside the domain of the securities acts, predictions by persons whose access to information is not as good as the issuer's. When the issuer adds its information and analysis to that assembled by outsiders, the collective assessment will be more accurate even though a given projection will be off the mark."[27]

The Court determined that the undeveloped record revealed no basis upon which to conclude either that Baxter's cautionary statements identified those "sources of variance that (at the time of the projection) were the principal or important risks," or that Baxter did not need to amend the cautionary language as the risks facing the company changed, thus precluding reliance at that juncture on the safe harbor.[28] Accordingly, the Court reversed the district court's dismissal.

Oracle And The PSLRA's Heightened Pleading Standard

The Ninth Circuit's *Oracle* decision considered plaintiffs' appeal from the district court's dismissal of their complaint against Oracle Corporation ("Oracle") and three of its senior-most executives.[29] Specifically, plaintiffs alleged that Oracle released its 11i Suite – software designed to allow a company to manage its financial, manufacturing, sales, and other information – without sufficient technical development and that, as a result, the software contained numerous defects that, combined with a slowing economy, significantly lowered Oracle's sales by the second quarter of Oracle's 2000 fiscal year.[30] But according to plaintiffs, Oracle hid this by, among other things, supposedly creating phony sales invoices and improperly recognizing previous overpayments as revenue, thereby inflating Oracle's earnings by approximately two cents per share and its revenues by $230 million.[31]

When Oracle released its results for the second quarter of 2000, it further predicted increased earnings for the fol-

Continued on page 6

PSLRA's Safe Harbor And Pleading Requirements

Continued from page 5

lowing quarter, as well as dramatic sales growth. Oracle suggested through its public filings, and through oral statements by the company's top executives, that it was unaffected by the downturn in the economy and that the downturn in fact would "provide new opportunities for Oracle as companies need to streamline and be more strategic about the technology they buy."[32] During this same period, Oracle's Chief Executive Officer, Lawrence Ellison, and Chief Financial Officer, Jeff Henley, both sold large amounts of Oracle stock.[33] One month later, Oracle disclosed that it would not meet its earnings or revenue estimates and that sales growth would be significantly lower than expected.[34] Plaintiffs alleged that Oracle was aware of, and should have disclosed, this information much earlier in the quarter.[35]

The district court dismissed plaintiffs' complaint for failing to meet the PSLRA's heightened pleading requirements. The Ninth Circuit summarized those requirements as follows:

> To avoid dismissal under the PSLRA, the Complaint must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which the belief is formed." . . . In addition, the PSLRA requires that the Complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," or scienter. The required state of mind is one of "deliberate recklessness."[36]

The district court held that although Oracle's forecasts and statements were actionable, plaintiffs' allegations "did not create a strong inference that these statements were known to be false when made."[37]

The Ninth Circuit reversed. First, acknowledging that "[t]he most direct way to show both that a statement was false when made and that the party making the statement knew that it was false is via contemporaneous reports or data, available to the party, which contradict the statement,"[38] the Court found that Oracle's current-up-to-the-last-hour sales database offered "a substantial window into the overall financial health of the corporation" and that Oracle, as a consequence, should have known that it would fall short of its projected earnings.[39] The Court noted that "'a proper complaint which purports to rely on the existence of internal reports would contain at least some specifics from those reports as well as such facts as may indicate their reliability,'" and held that plaintiffs' reference to "hard numbers" and allegations regarding "large portions of Oracle's sales data" satisfied this standard.[40]

Second, the Court found that "suspicious" stock trading by Oracle's seniormost executives a month before the company announced its lower-than-expected results further supported a strong inference of scienter. In evaluating the suspiciousness of Oracle's insider stock sales, the Court considered (i) the amount and percentage of shares sold; (ii) the timing of the sales; and (iii) their consistency with the executives' previous trading practices.[41] Ellison, for example, sold 29 million Oracle shares during this period (valued at almost $900 million), when he had not sold any Oracle stock in the preceding five years.[42] Although these 29 million shares represented only 2.1% of the CEO's total holdings, the Court found this "truly astronomical figure" evidence of suspicious trading, lending further credence to plaintiffs' allegations of scienter.[43]

Third, the Court inferred from public statements made by Oracle's seniormost executives that "even as it was making optimistic statements to the public, Oracle had known that it would not make its third quarter sales projections due to declining sales . . . and defects in the 11i Suite."[44]

The Court's final holding with respect to plaintiffs' allegations of scienter concerned Oracle's allegedly improper revenue accounting. Plaintiffs had alleged that Oracle "credited the amount of . . . debit memos [reflecting overpayments by the company's customers] as revenue, thereby artificially inflating the amount of revenue reported . . . at the end of the second quarter."[45] Plaintiffs corroborated these allegations through expert witnesses, including a former financial analyst who reviewed the billing and payment histories of several Oracle customers and discussed the accounting treatment with Oracle employees.[46] Contrary to the district court's determination, the Ninth Circuit found that plaintiffs' allegations in this regard, viewed together with the debit memos themselves and Oracle's SEC filings, adequately alleged improper revenue adjustments by the company.[47] Moreover, the Court determined that as a result of the defendant executives' "hands-on" and "detail-oriented management style," it was reasonable to infer they were aware of the allegedly improper revenue recognition.[48]

The Court held that plaintiffs' allegations, in the aggregate, were sufficient to withstand Oracle's motion to dismiss:

> Considered separately, Plaintiffs' allegations may not create a strong inference of scienter. However, we must consider "whether the total of plaintiffs' allegations, even though individually lacking, are sufficient to create a strong inference that defendants acted with deliberate or conscious recklessness." We find that the totality of the allegations does create a strong inference that Oracle acted with scienter, and we reverse the District Court.[49]

Accordingly, the Ninth Circuit reversed the district court's dismissal of the complaint.

1. 377 F.3d 727 (7th Cir. 2004) (Easterbrook, C.J.).
2. 380 F.3d 1226 (9th Cir. 2004) (Ferguson, C.J.).
3. 377 F.3d at 734.
4. 380 F.3d at 1230 (quoting 15 U.S.C. § 78u-4(b)(2)).

5. *Id.* at 1234 (citing *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding Corp.*, 320 F.3d 920, 938 (9th Cir. 2003)).

6. 377 F.3d at 728.

7. *Id.*

8. *Id.* at 728-29.

9. *Id.* at 728 (citing *Asher v. Baxter Int'l Inc.*, 2003 U.S. Dist. LEXIS 12905, 2003 WL 21825498 (N.D. Ill. July 17, 2003)); *see also* 15 U.S.C. §§ 77z-2(c) and 78u-5(c).

10. *Id*. at 729 (quoting 15 U.S.C. § 77z-2(c)(1)(A)(i)).

11. *Id.* at 730.

12. *Id.* at 730-31.

13. *Id.* at 731.

14. *Id*.

15. *Id*.

16. *Id.* at 732 (citations omitted).

17. *Id.* at 729 (citation omitted).

18. *Id.* at 732.

19. *Id.* (citing *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 359 (2d Cir. 2002); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 558-59 (6th Cir. 2001) (en banc); *Ehlert v. Singer*, 245 F.3d 1313, 1320 (11th Cir. 2001); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 182-83 (3d Cir. 2000); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999)).

20. *Id.* at 732.

21. *Id.* at 733.

22. *Id*.

23. *Id*.

24. *Id*.

25. *Id.* at 733-34.

26. *Id.* at 734.

27. *Id.* (quoting *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514 (7th Cir. 1989)).

28. *Id*.

29. 380 F.3d at 1227.

30. *Id.* at 1228.

31. *Id*.

32. *Id*.

33. *Id.* at 1228-29.

34. *Id.* at 1229.

35. *Id*.

36. *Id.* at 1230 (quoting 15 U.S.C. § 78u-4(b)(1); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 975 (9th Cir. 1999)).

37. *Id*.

38. *Id*.

39. *Id.* at 1231.

40. *Id.* at 1230-31 (quoting *In re Silicon Graphics*, 183 F.3d at 985).

41. *Id.* at 1232 (citing *In re Silicon Graphics*, 183 F.3d at 986).

42. *Id*.

43. *Id*.

44. *Id.* at 1232-33.

45. *Id.* at 1233.

46. *Id*.

47. *Id.* at 1233-34.

48. *Id.* at 1234.

49. *Id.* (quoting *Am. West*, 320 F.3d at 938). In reversing the district court, the Ninth Circuit also recognized that paraphrased statements by a company's analysts, "when . . . originated from the [company], and [which] do not represent a third party's projection, interpretation, or impression, . . . may be held to be actionable even if they are not exact quotations." *Id.* at 1235.

No D & O Coverage

Continued from page 3

referred to, when it states that the claim must arise from 'an Insured having gained in fact any personal profit . . . to which *such Insured* was not legally entitled.'" The court stated that the "use of more specific language within the same provision" indicates that "'an Insured'" does not necessarily refer to the same insured against whom the claim was brought."

Accordingly, the majority concluded, "[i]f the claims against . . . the other officers/directors are claims against Insureds arising out of Greene's personal profit, then the Personal Profit Exclusion is applicable to . . . the other officers and directors."

The Corporation

The majority also held that the personal profit exclusion excluded coverage with respect to PinkMonkey.com (which was covered under the policy for its own liability pursuant to a securities claim endorsement) because the policy's "Limits of Liability" provision stated that "[a]ll claims arising from the same Wrongful Act or interrelated or continuous Wrongful Acts of one or more Insured[s] shall constitute a single Claim." The majority found that the claims against Greene and the claims against the corporation arose from the same wrongful act – *i.e.*, misrepresentations made to obtain capital – and thus constituted a single claim, and, "[a]s such, the claim against the Company is also a claim against an Insured."

The Dissent

Judge Pickering's dissent disagreed with the majority's conclusion with respect to the claims against PinkMonkey.com's directors and officers other than Greene and the claims against PinkMonkey.com.

Judge Pickering stated that the personal profit exclusion was "susceptible of more than one reasonable interpretation" and that "well established" law requires that "we must resolve the uncertainty by adopting the construction that most favors the insured." Judge Pickering pointed to cases holding that "[i]n particular, exceptions or limitations on liability are strictly construed against the insurer and in favor of the insured" and that "[t]he court must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be the more reasonable or a more accurate reflection of the parties' intent."

Judge Pickering reasoned as follows with respect to the same language in the personal profit exclusion that the majority held excluded coverage for all directors, not Greene:

> This Exclusion uses the word "Insured" three times. Each time the word "Insured" is singular. Each time it is used, it is modified by a different adjective. Chronologically, "Insured" is modified by "any," "an," and "such." According to the dictionary, "any" means "one," singular, but it can mean "some," plural. "An" is clearly singular. "Such insured" refers back to "an insured." So, the third time the word "insured" is used in

Continued on page 8

No D & O Coverage

Continued from page 7

> the exclusion it clearly refers back to the second time the word insured is used.
>
> According to the dictionary definition, the word "any" can be interpreted as being singular or plural. Consequently, appellants' contention that it is to be construed as being singular is not unreasonable. Bolstering appellants' interpretation is the fact that each time the word "insured" is used, it is singular and that the words "such insured" refer back to "an insured." Again, interpreting the word "any insured" as being singular, and "such insured" as referring back to the specific insured who profited or gained inappropriately, appellants' construction of the exclusionary clause is not unreasonable.
>
> Accordingly, it is not unreasonable to interpret the EXCLUSION as excluding from coverage only a claim against the single insured who gained a profit or advantage to which he was not legally entitled.

Judge Pickering stated his view that that the interpretation of these words advocated by the insured directors and officers (other than Greene) "is not only a reasonable interpretation, but in the mind of this writer, it is more consistent with the wording of the exclusion." Judge Pickering also stated that "it is incongruous" to construe an insurance policy in a way that excludes coverage against certain insureds if they are sued alone but not if they are sued jointly with an insured who has received a personal benefit.

Judge Pickering also disagreed with the majority's reliance upon the policy's "Limits of Liability" provision – providing that "all claims arising from the same wrongful act or interrelated, repeated, or continuous wrongful acts of one or more Insureds shall constitute a single claim" – "in order to get around the fact that the wording of the exclusion only excludes a claim against an 'insured' and not the company" in a policy that, "by its own terms, provided for separate coverage as to each insured and the company."

"D & O policies should be reviewed to ensure coverage for innocent directors and officers for conduct that may trigger a personal profit exclusion with respect to any other director or officer."

Judge Pickering stated that this provision "is not found in the Definition section of the policy," which "gives the word 'claim' an entirely different definition": "a written demand for monetary damages, including the institution of suit or a demand for arbitration." Judge Pickering stated that where a term is defined one way in the "Definition" section of an insurance policy and in another way in the "Limits of Liability" section, "it is not unreasonable to construe th[e] definition of 'claim'" in the Limits of Liability provision "as being applicable only to the Limits of Liability" and "to interpret this as limiting the insurer's limits of liability and not the extent of coverage."

Judge Pickering concluded as follows:

> If one uses the definition of "claim" as defined in the Definition section of the subject insurance policy and interprets the word "any" as being singular as the word is defined in the dictionary, the exclusion would read as follows: This insurance does not apply to "a written demand for monetary damages, including the institution of suit" made against "any insured" (one insured) arising out of any of the following: any suit based upon, arising from or in consequence of an insured (one insured) having gained in fact any personal profit, remuneration, or advantage of which *such* insured was not legally entitled.

Judge Pickering stated his view that "[t]o read the word 'company' into this exclusion is less reasonable than to read the company out of the exclusion since TIG clearly knew how to amend the policy and in fact amended the Definition section by the Endorsement in several respects."

Finally, Judge Pickering took particular issue with the majority's assertion – quoted above – that "[a]lthough the terms 'the insured' 'that insured' or 'such insured' preceding personal profit *would indicate* the same insured as the claim is brought against, the personal profit exclusion uses the more general term 'an insured' and that "*[t]his indicates* that coverage is excluded for all insureds, not merely the insured who profited" (emphasis added by Judge Pickering). Judge Pickering stated that this statement by the majority "proves the point of this dissent":

> Whether the words "an insured" indicates that coverage is excluded for all insureds is not the test. The test is whether or not there is another reasonable interpretation of the exclusion which is to be particularly construed against the insurer. The exclusion is not expressed in clear and unambiguous language as Texas law requires. . . . The majority finds that the words "an insured" *indicates* that coverage is excluded for all insureds. The majority notes that the terms "the insured," "that insured" or "such insured" *would indicate* the same insured as the claim is brought against, thus providing coverage to appellants. The majority then chooses between these two indications.

In Judge Pickering's view, "[i]t is not enough that an insurance policy indicates that an exclusion is involved." Rather, "the exclusion must be stated in clear and unambiguous terms."