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FINANCIAL SERVICES ALERT

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2011'S TOP 10 FINANCIAL SERVICES U.S. COURT AWARDS AND SETTLEMENTS

We have compiled for your consideration a list of the past year's top 10 court awards and settlements in the U.S. involving Financial Institutions in the areas of D&O, E&O, EPL and Fiduciary Liability, which we believe will impact these exposures in the coming year and beyond. 2011 provided us with continued fallout from the Credit Crisis, with the impact ranging from how regulatory proceedings are conducted to landmark civil settlements. We also saw one of the highest profile insider trading cases in years culminating in historic penalties and jail sentences. We look forward to discussing these and other matters with you during the coming year.

1. CITIGROUP

The court's decision **not** to approve the proposed $285 million settlement with the Securities and Exchange Commission (SEC) challenged the Commission's practice of letting firms settle enforcement actions without either admitting or denying liability. In rejecting the settlement, and refusing to defer to the SEC, the judge cited the public's interest in learning the truth about the allegations that the bank defrauded investors in a collateralized debt obligation deal linked to bad residential mortgages. The SEC had accused the company of selling investors slices of a $1 billion mortgage-bond deal without disclosing it was betting against $500 million of those assets.[1] **[Impact: D&O]**

2. MERRILL LYNCH

The claim alleged that Merrill Lynch violated Securities Exchange Act of 1934 by failing to disclose material facts about certain auction rate securities it sold. In what appears to be the first decision of its kind stemming from class action litigation over the collapse of the auction-rate securities market, a federal appeals court held that the firm **had** made adequate disclosures to customers. This is yet another blow to deference to the SEC's position (the Commission had filed an amicus, or friend of the court, brief supporting the plaintiff).[2] **[Impact: E&O]**

3. JANUS

The U.S. Supreme Court held that the firm could not be sued for what might be misleading statements in the prospectuses of its mutual funds because it and its subsidiary that advised the funds were separate legal entities from the mutual funds themselves. Investors had argued that while the firm and its advisory subsidiary are separate legal entities from the mutual funds, in practice, they ran the day-to-day operations of the mutual funds and should be held liable for misleading prospectus information. This win has important implications for the mutual fund industry and investment advisers, but also for accountants and others who provide services to issuers or participate in the writing and preparation of prospectuses and other documents, which, unlike the issuers, do not have ultimate authority over the issuers' statements.[3] **[Impact: D&O, E&O]**

4. TRUSTEE FOR THE LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC

After the massive Ponzi scheme was discovered and the firm put into bankruptcy, the court-appointed trustee sought to make recoveries for those who had their lost investments; in doing so, the trustee brought suit, seeking roughly $20 billion from several banks and investment funds alleging that they aided and abetted the fraud. The appeal court refused to approve these common law actions, limiting recoveries to the fictional profits withdrawn during a period before the collapse of the Madoff firm, which according to the trustee's calculations would be less than $500 million, a fraction of the sums sought. With two solid decisions favoring the financial institutions, it appears that the courts are not favoring a plaintiff-based expansion of the law of recoveries.[4] **[Impact: E&O, Fidelity]**

5. CIGNA

The case involved alleged misstatements by the firm to its employees about changes in their pension plan; the provided summary of the changes allegedly characterized them as being more generous than they actually were. The employees brought a class action asking that the terms of the plan be reformed to reflect more generous terms than the plans currently provided. The U.S. Supreme Court held that summaries of the plan were not part of the documents that formed rights and obligations between ERISA plans and their participants and beneficiaries (good), but, remanded the case for further proceedings, making clear that whether the erroneous information provided to the employees occurred by mistake or with bad intent, ERISA may well provide money damages to the participants in the form of equitable relief (bad).[5] **[Impact: Fiduciary]**

6. UNION BANK NA

More than 30 nationwide lawsuits were brought by consumers alleging that that more than 30 banks processed debit card transactions non-sequentially to deplete their checking accounts and trigger overdraft fees (this preceded last year's Federal Reserve rule prohibiting lenders from automatically charging fees when consumers have insufficient funds for electronic or debit transactions). The $35 million settlement related to overdraft fees is one of the first but will not be the last in this line of cases. When considered in light of the new Consumer Financial Protection Bureau created by the Dodd-Frank Wall Street Reform and Consumer Protection Act, it may signal the need to change previous policies and methodologies when dealing with consumers.[6] **[Impact: E&O, Operational Risk]**

7. RAJ RAJARATNAM

Proving that securities enforcement can be personal, the former hedge fund manager received the longest sentence yet for insider trading – more than 11 years in prison – and was ordered to pay a record penalty of more than $92.8 million in a related civil case brought by the Securities and Exchange Commission.[7] **[Impact: E&O, D&O]**

8. WAMU

In 2010, the Federal Deposit Insurance Corporation (FDIC) sent the message they were kicking tail and taking names by announcing they had targeted 373 executives of failed banks responsible for billions in losses. Their showcase filing was a highly publicized lawsuit against three prominent former executives of WaMu, the largest bank failure in U.S. history, and they made it personal by suing their spouses too. Did the $64.7 million settlement (with personal contributions of $425,000 by the individual executives) back up their tough talk? While the FDIC announced it was "pleased" with the settlement and lauded its efforts in obtaining personal contributions,[8] others have been critical, deriding them as "slapped wrists" and "soft," but suits by regulators against individuals (and spouses) give us cause for concern, with potentially hundreds of additional suits still to be filed by the FDIC.[9] **[Impact: D&O, E&O]**

9. WACHOVIA

Settled for $629 million, this is the largest credit crisis settlement (narrowly exceeding the $624 million Countrywide settlement).[10] All counted, there were 23 credit crisis settlements in 2011 totaling approximately $2.48 billion, with an average settlement of $108 million. Despite a purportedly higher dismissal rate for credit crisis lawsuits, the losses are accumulating quickly and playing a part in the firming up of the marketplace for management and professional liability coverage for Financial Service firms. **[Impact: D&O, E&O]**

10. CITIGROUP

ERISA tagalong or stock-drop cases (similar to D&O stock-drop cases but brought by the firm's own pension plans that held the company's own stock) have been a very expensive line of fiduciary cases. In this decision, the influential Second Circuit dismissed the case at the pre-discovery stage. It should be easier now for defendants to prevail (at the early stage), but some cases are already being crafted to try and circumvent this strong pro-defense decision.[11] **[Impact: Fiduciary]**

CONTACTS

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[1] The decision came from U.S. District Judge Jed Rakoff in Manhattan, who has challenged significant SEC settlements in the past, such as 2009's proposed $33 million agreement between the SEC and Bank of America Corp. (*SEC Policy Challenged in Judge's Rejection of $285 Million Citigroup Deal*, Bloomberg, November 29, 2011).

[2] *Wilson v. Merrill Lynch Co Inc*, Docket No. 10–1528–cv, November 14, 2011, one of the cases consolidated into *In re Merrill Lynch Auction Rate Securities Litigation*, Master Case File No. 08-cv-3037 (LAP). Auction rate securities can be either municipal or corporate debt securities or preferred stocks, which pay interest at rates set at periodic "auctions." Auction rate securities generally have long-term maturities or no maturity dates. This decision relied in part on *Ashland Inc. v. Morgan Stanley & Co.*, 652 F.3d 333 (2d Cir.2011), decided earlier in this year, which dealt with similar claims from a sophisticated investor who had purchased student loan-backed auction rate securities having substantially similar website disclosures.

[3] *Janus Capital Group, Inc. v. First Derivative Traders,* No. 09–525. Decided June 13, 2011.

[4] *Irving H. Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC v. JPMorgan Chase & Co., No. 11 Civ. 913 (CM),* and *Irving H. Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC v. UBS AG, et al,* No. 11 civ. 4212 (CM), October 31, 2011.

[5] *CIGNA v. Amara,* Case No. 09-804, 2011 U.S. LEXIS 3540.

[6] *In Re Checking Account Overdraft Litigation,* 09-cv-02036, U.S. District Court, Southern District of Florida Miami). Interestingly, the defendants in this line of cases had sought to have these matters arbitrated based on arbitration provisions in the relevant Bank Service Agreements. In May of 2010, the court held the arbitration agreements at issue were unconscionable under applicable state law, and so not enforceable. At the time, the inclusion of a class-action waiver in an arbitration agreement was a significant factor weighing in favor of finding the agreements unconscionable, and thus unenforceable, under the laws of all four states at issue. In light of the more recent Supreme Court decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), which found the "*Discover Bank* rule" preempted by the Federal Arbitration Act, the court was asked to reconsider its ruling on unconscionability, without consideration of the class-action waivers in the Agreements. Ultimately, based on its conclusion that monetary damages would be "otherwise inadequate" to remedy the plaintiffs because part of the "relief request is not expressly stated as a dollar amount," and so do not fall within the arbitration agreement, the court refused to compel the plaintiffs to arbitrate them.

[7] *SEC v. Galleon Management et al*, U.S. District Court, Southern District of New York, No. 09-08811. The penalty was imposed by U.S. District Judge Jed Rakoff and is in addition to the $63.8 million that the defendant was already assessed in his criminal case ($53.8 million that was forfeited and a $10 million fine). A federal jury back in May convicted Rajaratnam of 14 counts of securities fraud and conspiracy in the criminal case. U.S. District Judge Richard Holwell had imposed the 11-year prison term, the longest recorded U.S. sentence for insider trading. Rajaratnam is scheduled to begin his term on December 5. See: **http://www.huffingtonpost.com/2011/11/08/raj-rajaratnam-to-pay-928-million-in-sec-civil-suit_n_1082559.html**.

[8] See FDIC Press Release entitled "FDIC Announces Settlement with Washington Mutual Directors and Officers," **http://www.fdic.gov/news/news/press/2011/pr11192.html dated December 15, 2011**.

[9] See NY Times article "Slapped Wrists at WaMu" by Gretchen Morgenson on December 17, 2011.

[10] *In re Wachovia Preferred Securities and Bond/Notes Litigation*, Master File No. 09 Civ. 6351 (RJS).

[11] *In re Citigroup ERISA Litig.*, No. 09-3804, 2011 WL 4950368 (2d Cir. Oct. 19, 2011).